May 2009
IMF Country Report No. 09/153

Colombia: Arrangement Under the Flexible Credit Line—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Colombia

In the context of the arrangement for Colombia under the Flexible Credit Line, the following documents have been released and are included in this package:

- The staff report on the arrangement for Colombia under the Flexible Credit Line, prepared by a staff team of the IMF, based on information available as of May 4, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff supplement of May 5, 2009, on the assessment of the impact of the proposed Flexible Credit Line arrangement on the Fund's finances and liquidity position.

- A Press Release summarizing the views of the Executive Board as expressed during its May 11, 2009, discussion of the staff report that completed the request.

- A statement by the Executive Director for Colombia.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

COLOMBIA

Arrangement Under the Flexible Credit Line

Prepared by the Western Hemisphere Department
(In consultation with other departments)

Approved by Miguel A. Savastano and Tessa van der Willigen

May 4, 2009

- ***Background.*** Colombia has very strong fundamentals and institutional policy frameworks, which have allowed it to build a solid track record of very strong policies. These policies have allowed Colombia to maintain macroeconomic stability and reduce vulnerabilities considerably, as highlighted by the Executive Board in the recent 2008 Article IV consultation.
- ***Outlook.*** Colombia is well placed to confront the challenges posed by the ongoing global downturn. While the first-round effects of the crisis have been largely absorbed by the exchange rate and asset prices, the authorities are using monetary and fiscal policies to mitigate the effects on the real economy. Notwithstanding its very strong fundamentals, Colombia's outlook could be seriously affected if the global environment deteriorates further.
- ***FCL.*** Access under an FCL arrangement of SDR 6.966 billion (900 percent of quota)—which the authorities intend to treat as precautionary—would support Colombia's policy framework and strategy, while reducing the likelihood of balance of payments pressures stemming from a change in investor sentiment. Staff believes that Colombia fully meets the FCL qualification criteria, and recommends approval of the arrangement.
- ***Fund liquidity.*** The impact of the proposed commitment of SDR 6.966 billion on the Fund's finances and liquidity position would be manageable
- ***Process.*** An informal meeting was held on April 20, 2009 to consult with the Executive Board on a possible FCL arrangement for Colombia.
- ***Team.*** This report was prepared by a staff team led by Marco Piñón and comprising Enrique Flores, Laura Jaramillo, and Mercedes Vera Martin.

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I. A DECADE OF STRONG FUNDAMENTALS

1. **Following the crisis of the late 1990s, Colombia adopted wide ranging macroeconomic and structural reforms.** These included a comprehensive reform of public finances, fiscal decentralization, a new pension system, a flexible exchange rate and inflation targeting framework, privatization of public banks, and strengthening of financial supervision.

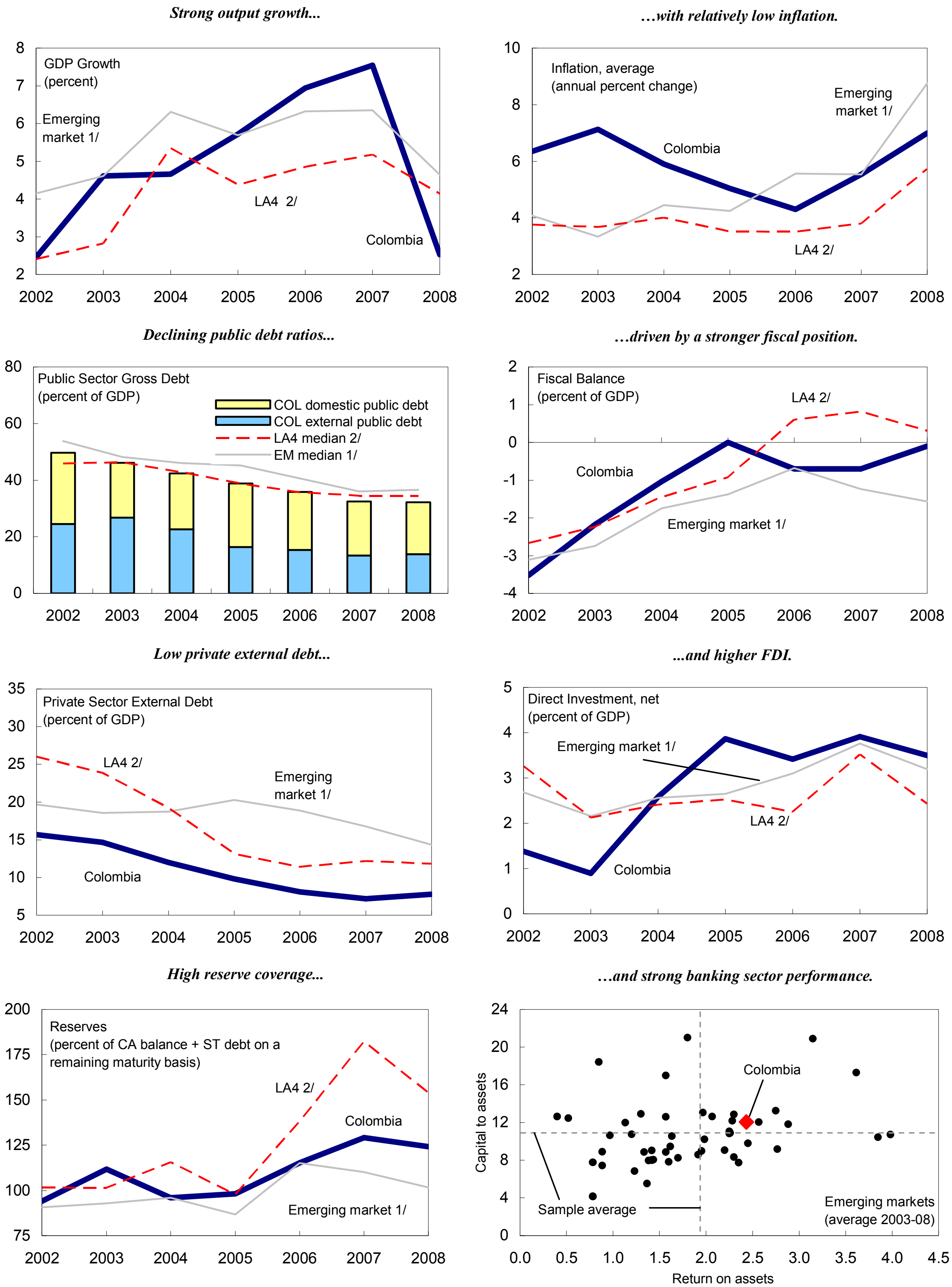
2. **Adherence to those policies and reforms contributed importantly to strong economic performance.** GDP growth averaged 5½ percent during 2004–08, well above the average of other large economies in the region, underpinned by a large increase in private investment (Figure 1). FDI flows increased to an annual average of 3.5 percent of GDP in the same period, fully financing the external current account deficit. In addition, Colombia took advantage of favorable external conditions to build up its liquidity buffers to comfortable levels, raising its international reserves by more than US$10 billion to the equivalent of 8 months of imports (almost 200 percent of short-term debt at remaining maturity) at end-2008.

3. **The inflation targeting regime adopted in 2000 brought inflation down.** Annual inflation fell from 18.0 percent in 1995–99 to 5.7 percent during 2002–07 as the new monetary policy framework took hold and modified entrenched inflation expectations and indexation mechanisms. Following a short-lived spike in 2007–08 due to oil and food price shocks, inflation started to decline in late 2008 and currently stands at 6.1 percent. Monetary policy has been prudent, with the central bank tightening monetary conditions to contain overheating pressures in 2006–07, and starting an easing cycle in late 2008 to support domestic demand after inflationary pressures began abating.

4. **Anchored on a medium term fiscal framework adopted in 2004, Colombia's debt ratios have declined.** The authorities' medium-term fiscal framework (published annually) guides fiscal policy and seeks to reduce public sector debt to 26 percent of GDP by 2019. The deficit of the combined public sector has been lowered from an average of 3 percent of GDP in the early 2000s to ½ percent of GDP during the last five years, owing to buoyant revenues and restraint on current expenditures. As a result, the public debt-to-GDP ratio fell from 42 percent in 2004 to 32 percent at end-2008.

5. **Balance sheet vulnerabilities have been contained, in part due to the flexible exchange rate regime and prudent debt management.** The flexible exchange rate regime has helped contain excessive private sector borrowing (private external debt halved between 2003 and 2008 to 7 percent of GDP), while serving as an effective shock absorber. Foreign exchange intervention has been rules-based, and geared at reducing short-term

Figure 1. Colombia: Strong Performance, 2002-2008



Sources: World Economic Outlook database; GFSR; and IMF staff estimates.
1/ Median of 49 emerging market economies.
2/ LA4 represents median of Brazil, Chile, Mexico, and Peru.

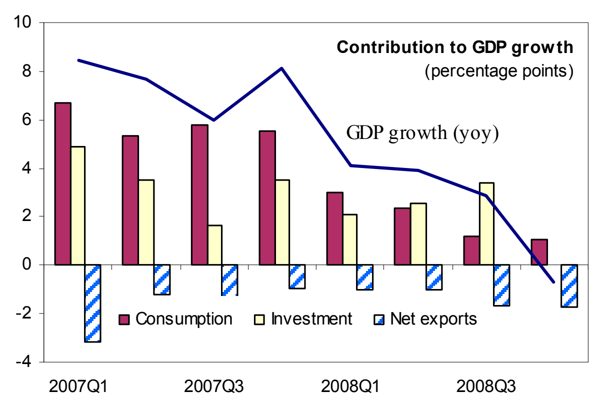
volatility. Effective public debt management has made government debt more resilient to exchange rate fluctuations and helped reduce external debt to about 12 percent of GDP in 2008. Corporate sector vulnerabilities also have declined, with large corporations showing adequate capitalization, low leverage ratios, and comfortable liquidity levels.

6. **Strong supervision and regulation has kept the financial system sound.** Capital to risk-weighted assets for the system as a whole has been stable at about 14 percent during the past 5 years, well above requirements. In addition, asset quality indicators have been strong, provisioning adequate, and liquidity buffers comfortable. The 2005 FSAP highlighted the achievement of major improvements in financial legislation and the supervisory system. Since then, the authorities have made substantial progress in implementing a risk-based supervisory framework consistent with Basle II, reformed regulations on derivatives, established countercyclical provisions, and enhanced regulations on liquidity risk. Recently, they have set up a high-level inter-agency committee to assess potentially adverse scenarios to the financial system and develop coordinated contingency plans.

II. Recent Developments and Policy Response

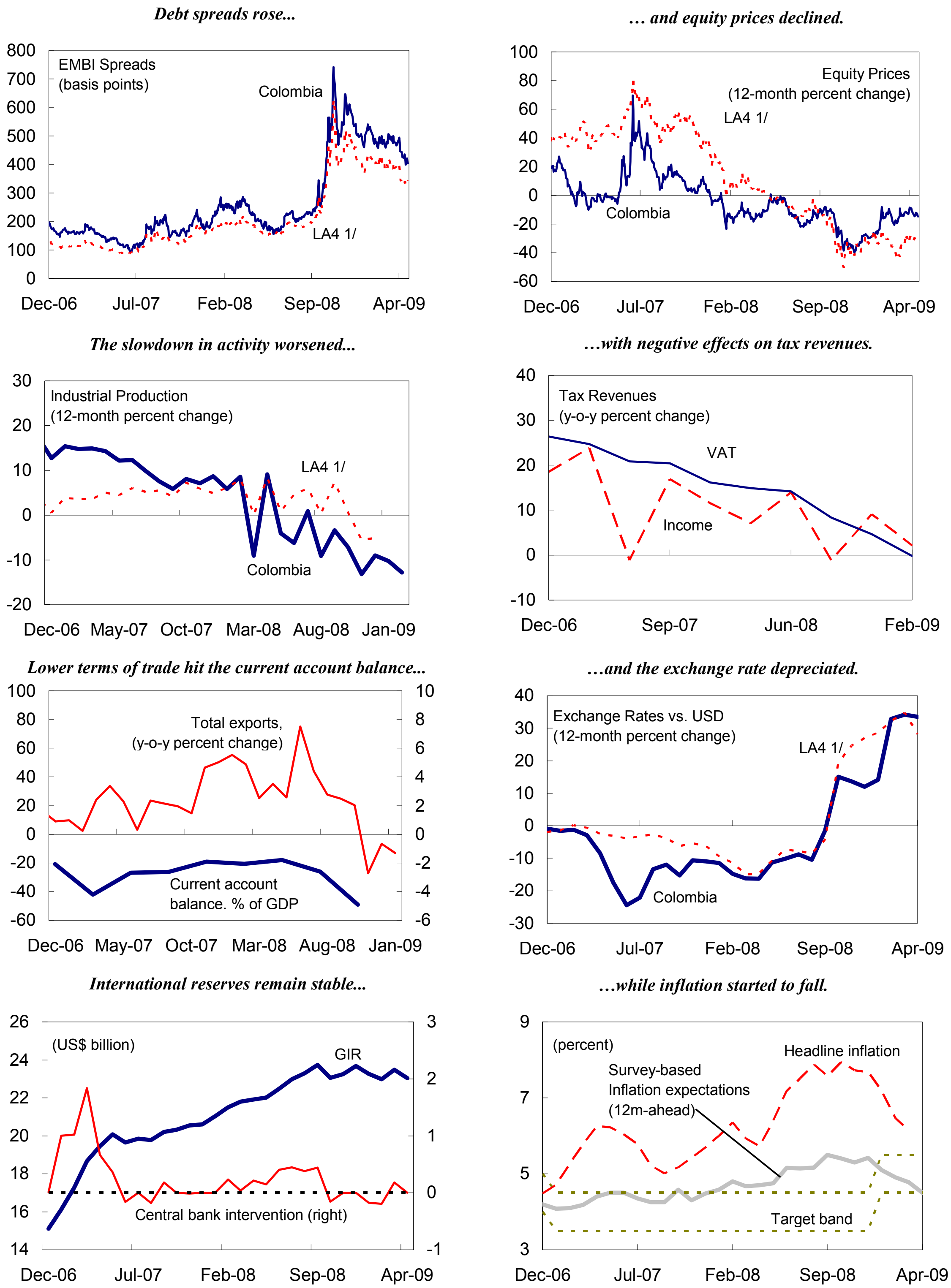
7. **Colombia's policies and outlook were last considered by the Board on January 14, 2009 (IMF Country Report No. 09/23).** The staff report summarized developments and policies as of October-November 2008. This section provides an update on recent developments and policy actions since then.

8. **The economic slowdown in 2008 was sharper than envisaged at the time of the consultation.** Real GDP growth was 2.5 percent, a full percentage point lower than projected at end-2008. In the last quarter of the year, GDP was 4.1 percent lower than in the previous quarter, and 0.7 percent lower than a year earlier. Lower domestic demand, especially investment, explained the bulk of the decline. Activity indicators (industrial production, retail sales, and exports) continue showing a downward trend in the first quarter of 2009 (broadly in line with developments across the region), suggesting zero growth in 2009.



9. **External conditions deteriorated markedly in late 2008.** The global turmoil lead to sharply higher sovereign spreads and lower equity prices in the last quarter of 2008. The weaker global environment affected exports and worker remittances (which declined 4 and 14 percent, respectively, in Q4 from a year earlier) and the effects have become more pronounced in the first quarter of 2009. As in the other inflation targeting countries of the

Figure 2. Colombia: Impact of the Global Crisis



Sources: Banco de la República; Department of National Statistics; Bloomberg; Haver; and Fund staff calculations.

1/ LA4 represents median of Brazil, Chile, Mexico, and Peru.

region, the exchange rate absorbed the first round effects of the global crisis, with the peso depreciating 20 percent vis-à-vis the U.S. dollar between September 2008 and March 2009. Interventions in the foreign exchange rate market have remained small and rules-based; amounting to about US$0.2 billion on net terms since end-2008.

10. **With inflation pressures easing, the authorities have started an easing monetary policy cycle to support domestic demand.** CPI inflation fell from 7¾ percent in November 2008 to 6.1 percent in March 2009, and core inflation is below 5 percent. Expectations measures suggest a continued downward trend in inflation to near the bottom of the 4½–5½ percent target range by end-2009. In light of this, the central bank changed its stance and has lowered its policy rate by 400 basis points (to 6 percent) since December 2008, indicating scope for further easing if downside risks to the economy materialize.

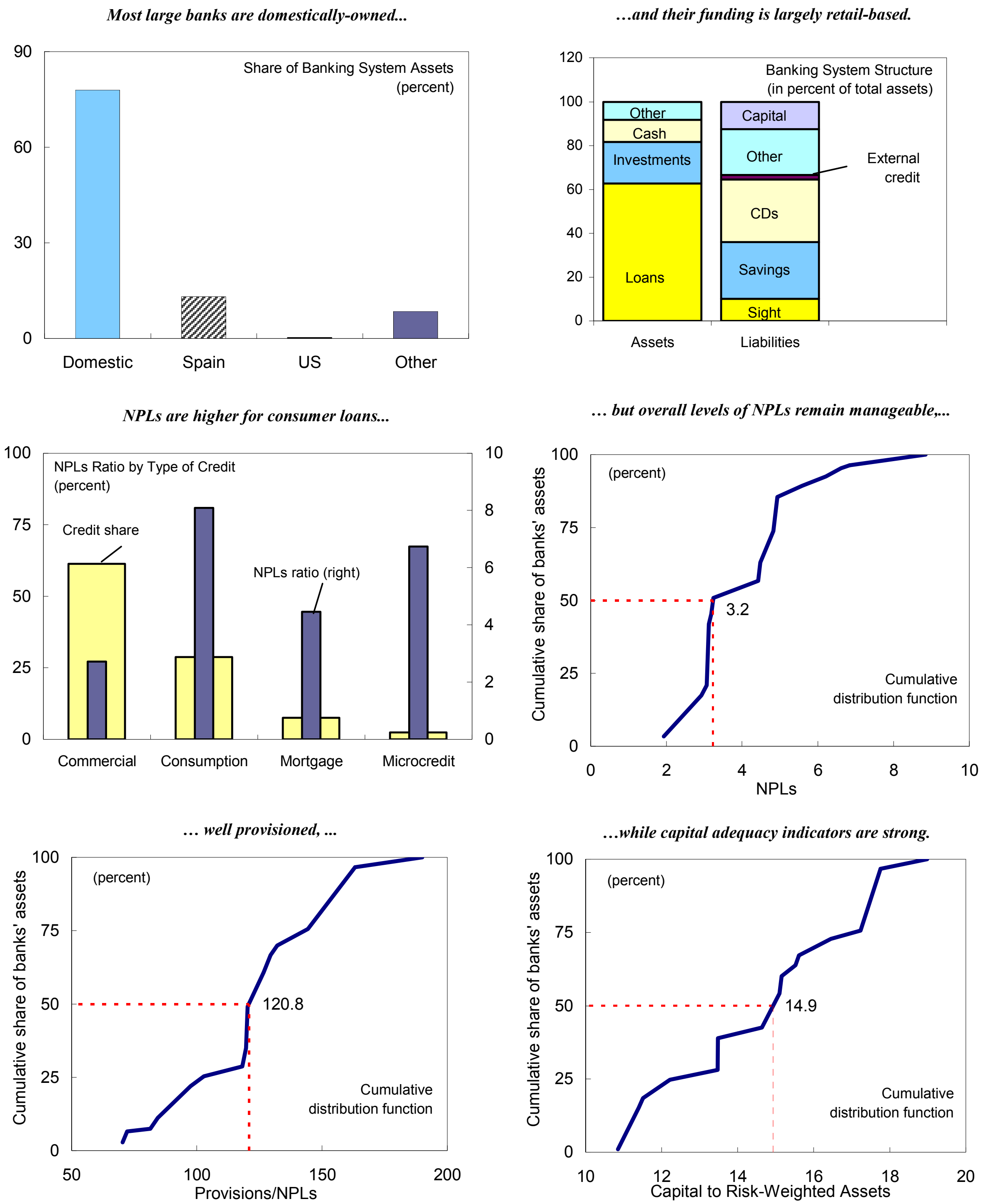
11. **Stalling tax revenues point to a deterioration in the fiscal position in 2009 but financing is unlikely to present problems.** The consolidated fiscal deficit in 2008 was 0.1 percent of GDP, 0.7 percentage points lower than envisaged at the time of the Article IV consultation, mostly due to lower than projected capital spending by local governments. However, the weakening economy has begun to take a toll on tax revenues, as income and VAT revenues have remained flat in the first months of 2009 compared to double digit growth rates in 2008. Against this backdrop, the authorities' revised fiscal strategy is to allow automatic stabilizers to work in full and give priority to infrastructure and social spending. In addition, the authorities have been proactively securing external financing, including through US$2 billion in bond placements and US$1.95 billion in multilateral loans.

Colombia: External Disbursements of MLT Debt for the Central Government
(in millions of US$)

	Staff Projections	
	2009	2010
Total	3,961	2,549
Multilaterals	1,952	1,512
Bilaterals	9	37
Private Creditors (including bonds)	2,000	1,000

Source: Direccion General de Credito Publico y Tesoro Nacional, and Fund staff estimates.

Figure 3. Colombia: Banking System 1/

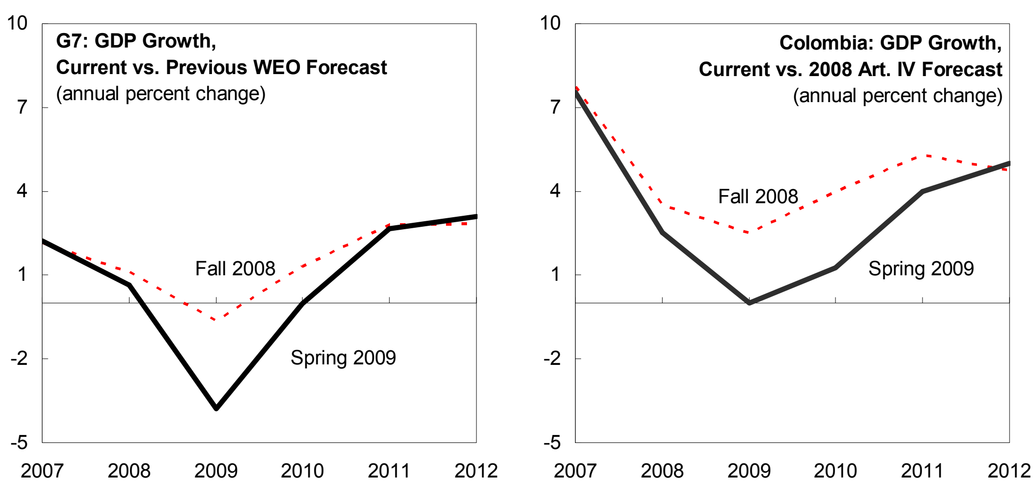


Sources: Financial Superintendence; and Fund staff calculations.
1/ Calculations based on the largest 15 banks, representing 87 percent of total assets.

12. **The financial sector remains sound**. Colombia's largely domestically-owned financial system has not experienced major strains since the onset of the global crisis. To increase the resilience of the system, since late 2008 the authorities raised the effective coverage of the deposit insurance, secured external financing for the state-owned foreign trade bank (BANCOLDEX) to provide loans to banks and corporations facing reduced access to external credit, and intensified the monitoring of liquidity conditions. Banks' balance sheets are strong, partly because of strict regulations on net open foreign positions, and have not been affected by the global deleveraging or by exposure to risky financial products, while corporate balance sheet vulnerabilities are low. The lower economic activity has been accompanied by higher NPLs, along with a slowdown in private sector credit growth. However, banks remain profitable (return on assets as of February 2009 was 2½ percent), provisioning levels are comfortable, and capital to risk-weighted assets for the system as a whole is about 15 percent (Figure 3).

III. Outlook and Risks

13. **Despite its very strong fundamentals, Colombia's near term outlook has been significantly affected by the global crisis.** The downward revisions in the World Economic Outlook projections since late 2008 point to a deeper and more protracted global recession, with serious implications for Latin America. For Colombia, staff now expects zero output growth in 2009 with a modest recovery in 2010 of about 1¼ percent (much lower than the rates of output growth envisaged in IMF Country Report No. 09/23—2 and 4 percent respectively).



14. **The global crisis is expected to affect negatively both the current and capital account of the balance of payments.** The external current account deficit is now projected to reach 3.9 percent of GDP in 2009, narrowing gradually over the medium-term. Exports are projected to decline sharply by 30 percent in 2009 (largely as a consequence of the sharp drop in export prices); and worker remittances by 17 percent. These lower current account inflows are expected to be partly offset by a fall in imports as a result of the slowdown in

economic activity, the depreciation of the peso, and lower FDI-related outflows. For 2010, staff projects a current account deficit of 3.3 percent of GDP, mainly driven by a partial recovery in commodity prices. On the capital account, foreign direct investment is expected to be about 25 percent lower than in 2008 and remain subdued in 2010, while private sector rollover rates are expected to be relatively low (at 70 percent on average for 2009 and 2010).

15. **The fiscal balance is expected to deteriorate in 2009-10 as automatic stabilizers are allowed to operate.** With a slowing economy, revenues are projected to fall to 26.3 percent of GDP, a 4 percent reduction in real terms from 2008 and 0.7 percent of GDP lower than envisaged at the time of the Article IV consultation. Revenues would remain weak in 2010, partly due to lags on income tax collection and lower profit transfers from Ecopetrol. Overall, staff projects a combined public sector deficit in the order of 3 percent of GDP in 2009-10, as real expenditure levels would be broadly maintained. This would imply structural primary balances close to 2 percent of GDP, similar to that of 2008. In line with this, the public debt to GDP ratio is expected to increase moderately to above 37 percent by 2010, but to regain its downward trend thereafter as the economy recovers and fiscal balances improve.

Colombia: Consolidated Public Sector
(In percent of GDP)

		2008		2009		2010	
	2007	Art. IV Board 1/	Actual	Art. IV Board 1/	Staff Proj.	Art. IV Board 1/	Staff Proj.
Total revenues	27.1	26.2	26.3	27.0	26.3	25.3	25.1
Tax	19.3	20.1	19.2	19.7	19.0	19.4	19.0
Nontax	7.8	6.1	7.1	7.3	7.2	5.9	6.1
Total expenditure	28.2	27.1	26.6	29.0	29.1	26.7	28.5
Current	21.8	21.5	21.6	22.7	23.1	21.2	22.7
Capital	6.4	5.6	5.0	6.3	5.9	5.5	5.9
NFPS balance	**-0.8**	**-0.9**	**-0.3**	**-2.0**	**-2.8**	**-1.4**	**-3.4**
Financial public sector balance	0.2	0.0	0.1	0.2	-0.1	0.3	0.3
Overall balance	**-0.7**	**-0.8**	**-0.1**	**-1.8**	**-2.9**	**-1.1**	**-3.1**
Memorandum items:							
NFPS primary balance	3.2	2.6	3.5	1.7	0.6	1.4	0.2
Structural primary balance	2.2	2.2	2.1	1.8	1.9	1.9	1.7

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Figures incorporate the data updates provided by staff during the Board discussion of the 2008 Article IV.

16. **While some of the risks envisaged at the time of the Article IV have materialized, a further deterioration in the external environment remains a concern.** A deeper or more protracted global crisis than already envisaged would pose additional challenges.

- The external current account could deteriorate further if global demand is weaker and/or commodity prices lower than projected. On the capital account, renewed turbulence in international markets that affects the emerging markets asset class could put further pressures on capital flows and the exchange rate. However, with external debt levels and financing requirements well below the median for emerging market countries, staff analysis suggests that the sustainability of Colombia's external debt would be robust to further shocks (Table 7).

- On the fiscal side, a deeper recession would lower fiscal revenues by more than projected or could make financing conditions more difficult. This would tend to exacerbate medium-term fiscal risks related to health care costs and special tax zones identified in the last Article IV consultation. However, strong initial conditions (i.e. a fiscal deficit and public debt lower or broadly in line with investment grade emerging countries) mitigates those risks. Staff analysis suggests that the policies embedded in the authorities' medium-term fiscal framework are sustainable, and resilient to additional significant shocks (Table 8).

Selected Vulnerability Indicators, 2009 1/
(In percent of GDP, unless otherwise indicated)

	Colombia	Median, sample of 49 emerging market countries	Median of emerging investment grade countries
External sector			
Gross reserves in percent of short-term debt at remaining maturity	183.8	152.0	129.2
Total gross external debt	24.6	41.2	43.2
Current account balance	-3.9	-3.3	-3.1
Foreign direct investment	3.2	2.0	2.0
Gross external financing requirement 2/	8.3	14.8	20.5
Public sector			
Overall balance	-2.9	-3.1	-3.0
Public sector gross debt	35.7	37.2	32.9
Of which: Exposed to exchange rate risk 3/	16.8	14.9	5.1
Exposed to rollover risk (ST debt, residual maturity) 4/	4.2	4.1	4.7
Financial system 5/			
Capital adequacy ratio, in percent	15.0	13.6	12.4
Non-performing loans, in percent of total loans	4.5	3.0	2.7
Return on average assets, in percent	2.5	1.6	1.4
Change in credit-to-GDP ratio, in percentage points 6/	2.6	2.0	3.3

Source: Fund staff estimates.

1/ Projection unless otherwise indicated.
2/ Current account balance plus maturing external debt.
3/ Debt in foreign currency or linked to the exchange rate, domestic and external.
4/ Short-term debt and maturing medium- and long-term debt, domestic and external, excluding external debt to official creditors.
5/ Latest available observation. In the case of Colombia, it refers to February 2009.
6/ Credit to the private sector.

- A further deterioration in economic activity would increase underlying credit risk. Financial institutions have built significant buffers to cope with adverse conditions. Moreover, the authorities have stepped up efforts to broaden the range of assets that can be used in repo operations, facilitating the provision of liquidity support, and are working toward improving their regulations on countercyclical provisions.

- A sharp depreciation of the peso or a sudden increase in the exchange rate pass through—particularly if they affect inflation expectations— would also be problematic. The scope for countercyclical monetary policy would be severely limited if inflationary pressures were to re-emerge.

IV. Role of the Flexible Credit Line and Access

17. **To be in a stronger position to withstand downside risks to their balance of payments, the Colombian authorities have requested Fund support in the form of a 12-month FCL arrangement in the amount of SDR 6.966 billion (900 percent of quota, or about US$10.4 billion)—which they intend to treat as precautionary.** Notwithstanding Colombia's very strong economic fundamentals and institutional policy frameworks, as well as its sustained track record of implementing very solid policies, a further deterioration in the global environment could create pressures on its external position. An FCL arrangement would bolster confidence in the authorities' policy framework and strategy. In particular, it would provide assurances that, even under a more adverse external environment, Colombia would be able to avoid major disruptions to its currency and financial markets, and continue gearing macroeconomic policies to support economic activity.

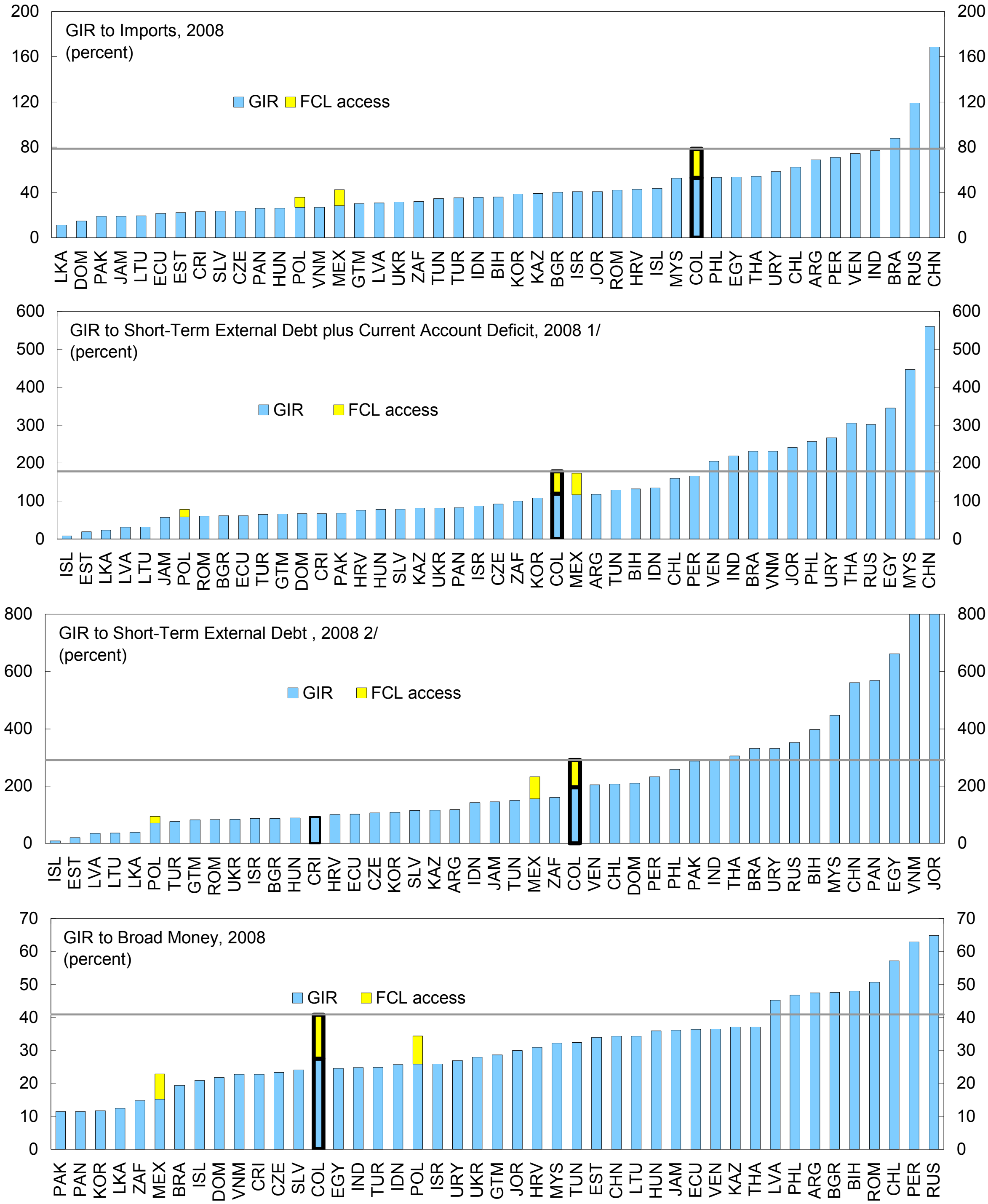
18. **Staff is of the view that the risks to the balance of payments justify the requested level of access.** As noted, staff's baseline projections already incorporate a significant deterioration in external conditions compared to the projections presented in the last staff report, with a decline in FDI and reduced debt rollover rates. In the current baseline, the annual gross external financing needs for 2009 and 2010 (Tables 2–3) are estimated to be in the order of US$20 billion, and would be fully financed. A more adverse external environment—with a further slowdown in commodity prices and FDI, and lower debt rollover rates—would give rise to positive net financing needs. An illustrative adverse scenario yields *ex-ante* annual financing gaps in the range of US$6–8 billion during 2009–10. The proposed access level would be in line with other high-access cases, for example in terms of GDP or in relation to exports and imports (Box 1); and would provide significant additional reserve coverage against these shocks (Figure 4).

Qualification Criteria

19. **Staff believes that Colombia qualifies for assistance under the FCL.** Colombia has very strong economic fundamentals and institutional policy frameworks, and has a sustained track record of timely implementation of very strong policies. In addition, the Board has assessed Colombia's policies very positively during recent Article IV consultations (Figure 5). Moreover, the authorities are firmly committed to such prudent

macroeconomic policies in the future, giving confidence that Colombia will respond appropriately to any balance of payments difficulties.

Figure 4. Colombia: Reserve Coverage in International Perspective, 2008



Sources: Haver Analytics; World Economic Outlook; and IMF staff estimates.

1/ Gross international reserves at the end of 2008 in percent of short-term debt at remaining maturity at the end of 2008 plus projected current account deficit in 2009.

2/ Gross international reserves at the end of 2008 in percent of short term debt at remaining maturity at the end of 2008.

Box 1. Access Level

An adverse illustrative scenario prepared by staff suggests that an access level of 900 percent of quota would provide Colombia liquid assets that are broadly commensurate with the potential balance of payments gap. The scenario assumes concurrent shocks to the current and capital account of the balance of payments, consistent with a worsening in global financial conditions and lower global economic growth. These global shocks are assumed to lower commodity prices further, which remain a key source of vulnerability for Colombia's balance of payments (commodity exports accounted for about 50 percent of export revenues in 2008).

Under the staff's alternative scenario, Colombia could face an ex-ante external financing gap of US$5.8 billion (502 percent of quota) in 2009, and US$8.2 billion (about 709 percent of quota) in 2010 (see Table 3). The key underlying assumptions of the alternative scenario are as follows (compared to the baseline):

- A 20 percent decline in fuel prices and a 10 percent decline in non-fuel commodity prices during 2009–10.
- A further decline in FDI (15 percent in 2009 and 10 percent in 2010).
- Aggregate rollover rates of 85 percent in 2009, given secured financing by the public sector but accounting for higher pressures in the private sector, notably corporates; and lower rollover rates in 2010.

The adverse global conditions under this scenario do not include a drawdown of non-resident holdings of domestic financial assets (estimated at about US$4 billion) nor do they trigger runs on bank deposits. The proposed access builds in some margin—relative to the weighted average of the possible gaps in 2009 and 2010—to guard against these and other additional potential risks.

Economic concept-based metrics for Colombia's proposed access level would be broadly in line with previous high-access cases.

Colombia: Proposed Access, 2009

	Proposed Arrangement	Poland Arrangement	Mexico Arrangement	High-Access Cases 1/ Proposed Arrangement (Percentile)	20th Percentile (Ratio)	80th Percentile (Ratio)	Average	Median
Access								
In millions of SDRs	6,966	13,690	31,528	82	1,579	13,291	8,339	6,901
Average annual access	900	1,000	1,000	97	142	508	322	248
Total access in percent of: 2/								
Actual quota	900	1,000	1,000	82	300	941	639	505
Gross domestic product	5	5	6	46	3	9	8	6
Gross international reserves	44	35	49	24	28	88	82	50
Exports of goods and nonfactor service	33	11	19	24	11	39	30	21
Imports of goods and nonfactor service	29	11	17	22	11	44	30	20
Total debt stock								
Public	15	10	10	36	7	31	21	12
External	22	8	24	30	6	17	13	12
Short-term external 3/	84	21	77	26	20	77	97	32
M2	34	11	10	30	8	25	25	13

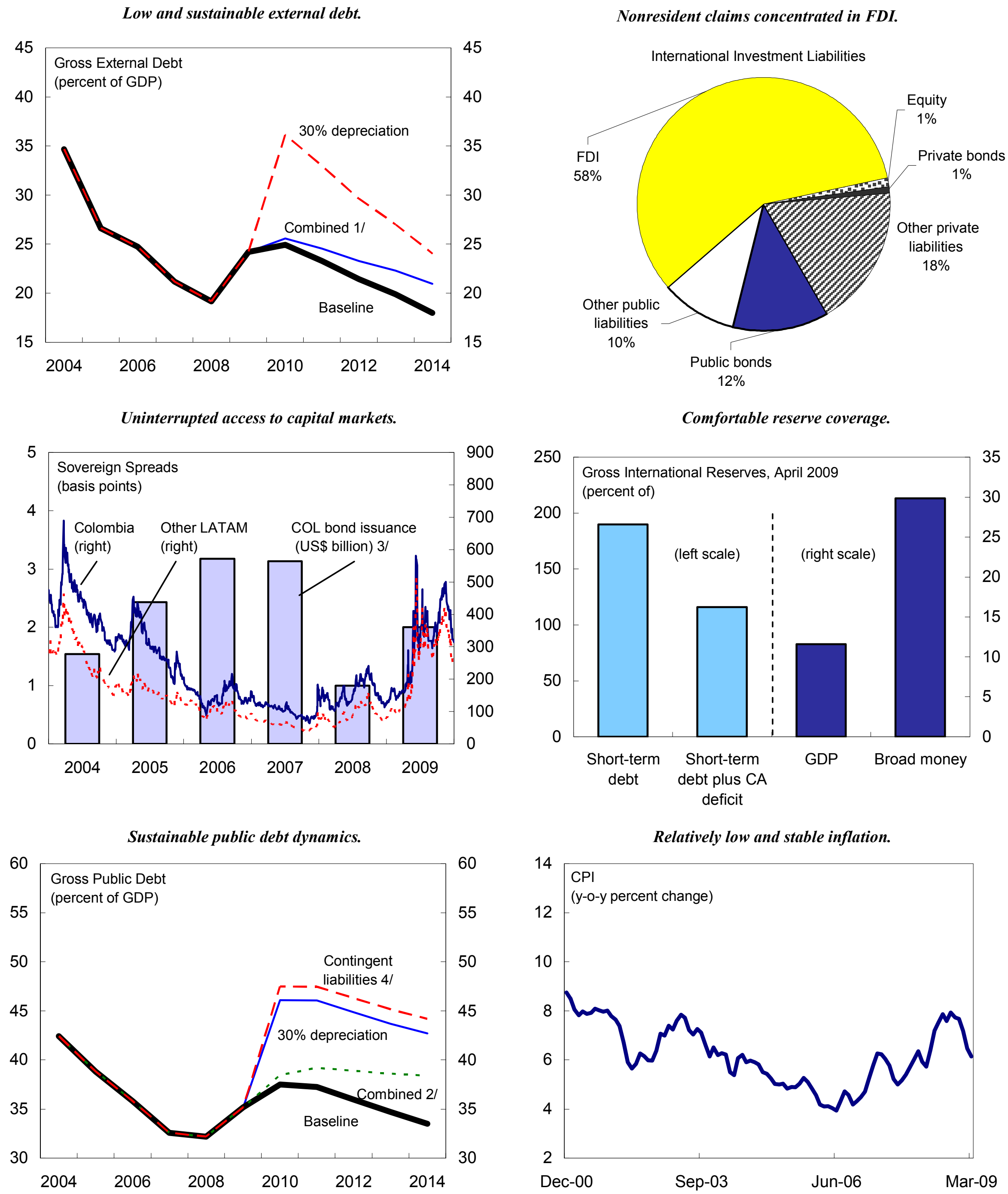
Source: Executive Board documents, MONA database, and Fund staff estimates.

1/ High access cases include available data at approval and on augmentation for all the requests to the Board since 1995 which involved the use of the exceptional circumstances clause or SRF resources. Exceptional access augmentations are counted as separate observations. For the purpose of measuring access as a ratio of different metrics, access includes augmentations and previously approved and drawn amounts.

2/ The data used to calculate ratios is the actual value for the year prior to approval for public and short-term debt, and M2, and the projection at the time of program approval for the year in which the program was approved for all other variables.

3/ Refers to residual maturity.

Figure 5. Colombia: Qualification Criteria



Sources: Banco de la Republica; Datastream; Haver; and IMF staff calculations.
1/ Combined permanent ¼ standard deviation shocks applied to interest rate, growth, and primary current account balance.
2/ Combined permanent ¼ standard deviation shocks applied to real interest rate, growth, and primary balance.
3/ 2009 data as of April.
4/ One-time 10 percent of GDP increase in debt-creating flows.

20. The staff assessment of Colombia's qualification is based, in particular, on the relevant criteria specified in (i)-(ix) of paragraph 2 of the FCL decision, as follows:

- **Sustainable external position.** Colombia's external debt-to-GDP ratio at end-2008 was 19.3 percent—15 percentage points lower than in 2004. The bulk of this debt is owed by the public sector and has long maturities. Private sector external indebtedness has declined to about 7 percent of GDP. The external current account deficit is expected to peak at 3.9 percent of GDP in 2009 and thereafter decline as a share of GDP, and be financed mostly by FDI. In addition, staff's debt sustainability analysis suggests that external debt ratios would remain manageable even under significantly negative shocks (Figure 6).

- **Capital account position dominated by private flows**. In recent years, capital account flows have been predominantly private—mostly in the form of FDI (3.5 percent of GDP in 2008).

- **Track record of steady sovereign access to international capital markets at favorable terms**. Although its sovereign debt rating is one notch below investment grade, Colombia's sovereign spreads and vulnerability indicators are similar to those of countries with higher credit ratings (see text table). Even in the current unsettled conditions, the government has been able to tap global capital markets at reasonable terms.

- **Relatively comfortable reserve position.** At US$23 billion at end April, reserves cover about 8 months of imports and 190 percent of short-term external debt on a remaining maturity basis. In a scenario similar to the staff's baseline, those levels of reserves would provide adequate coverage.

- **Sound public finances, including a sustainable public debt position**. Public debt has fallen in recent years to about 32 percent of GDP at end-2008. While the overall fiscal deficit is expected to increase in 2009–10 due to the global downturn, the authorities' rules-based fiscal framework over the medium term clearly establishes their commitment to further debt reduction. Staff's debt sustainability analysis suggests that under alternative adverse scenarios, public debt would remain manageable and on a downward trajectory (Figure 7).

- **Low and stable inflation, in the context of a sound monetary and exchange rate policy framework.** Policy credibility under the inflation targeting framework has been successful in curbing inflation and anchoring inflation expectations. The flexible exchange rate regime has eased adjustment to external shocks, with limited pass-through to prices.

- **Absence of systemic bank solvency problems that pose an imminent threat of a systemic banking crisis.** The banking system has not been seriously affected by the crisis, and financial soundness indicators remain strong. Recent stress tests undertaken by the authorities suggest that, under a variety of extreme shocks, all institutions of systemic importance would remain solvent.

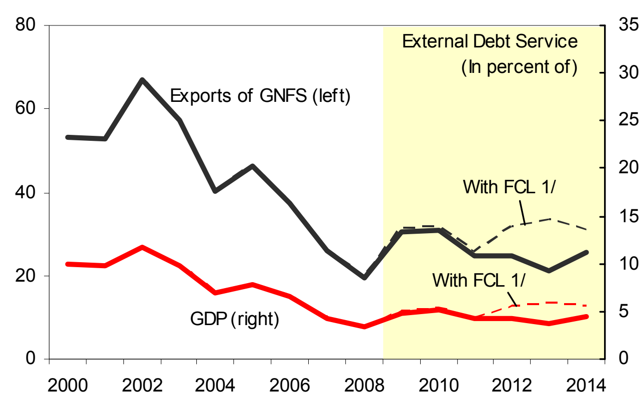
- **Effective financial sector supervision.** Colombia has a strong regulatory and supervisory framework. Supervision of the financial sector was unified under a single umbrella in 2005. The authorities have an adequate supervisory, legal, and institutional framework to intervene promptly in banks if needed—although the superintendent would benefit from greater independence. The financial safety net is well established, and operational coordination is being achieved through a high-level committee (comprising the ministry of finance, the central bank, the financial sector superintendency and the deposit insurance agency).

- **Data transparency and integrity.** The overall quality of Colombian statistics is good, as highlighted in the 2006 data ROSC. Colombia has been a subscriber to the SDDS and the authorities publish a wealth of data on-line.

V. Impact on Fund Finances, Risks, and Safeguards

21. **Access under the proposed FCL arrangement for Colombia of 900 percent of quota (SDR 6.966 billion) would be manageable for Fund finances.** The Fund's liquidity is expected to remain adequate after approval of an FCL arrangement for Colombia, as further discussed in the supplement assessing the impact on the Fund's finances and liquidity position.

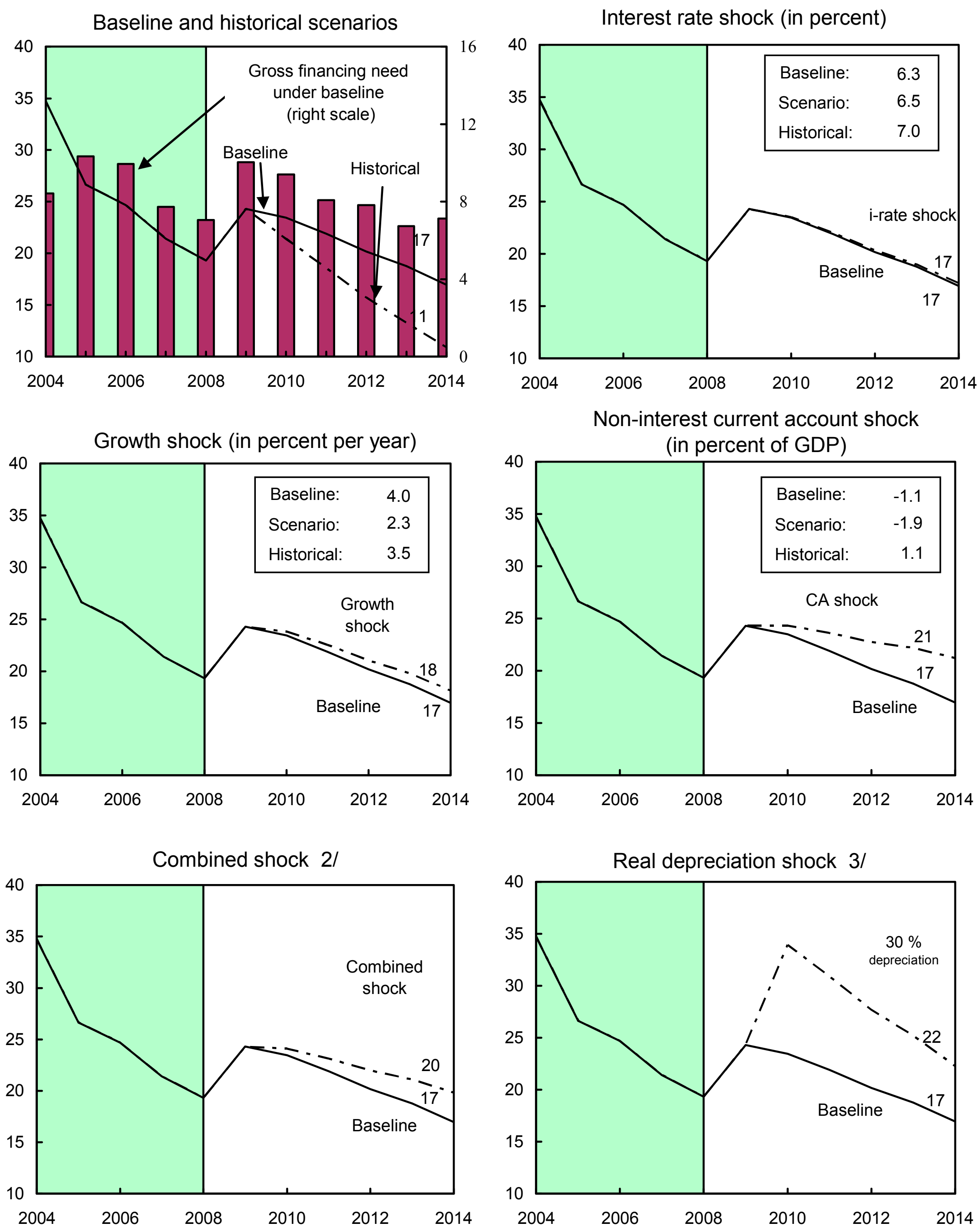
22. **Risks to the Fund are expected to be contained**. The authorities intend to treat the FCL arrangement as precautionary. Even if a full drawing under the arrangement were to be made shortly after approval, Colombia's external debt service would remain manageable, at 5¼ percent of GDP on average, and at 5.8 percent of GDP at its peak in 2013 (Table 9). Colombia has an outstanding track record of meeting its obligations to all creditors, and the authorities have a deep commitment to macroeconomic stability and prudent fiscal policies.[1] In addition, Colombia's growth prospects remain strong over the medium term.



1/ Assumes that the full amount of access under the FCL is drawn in 2009.

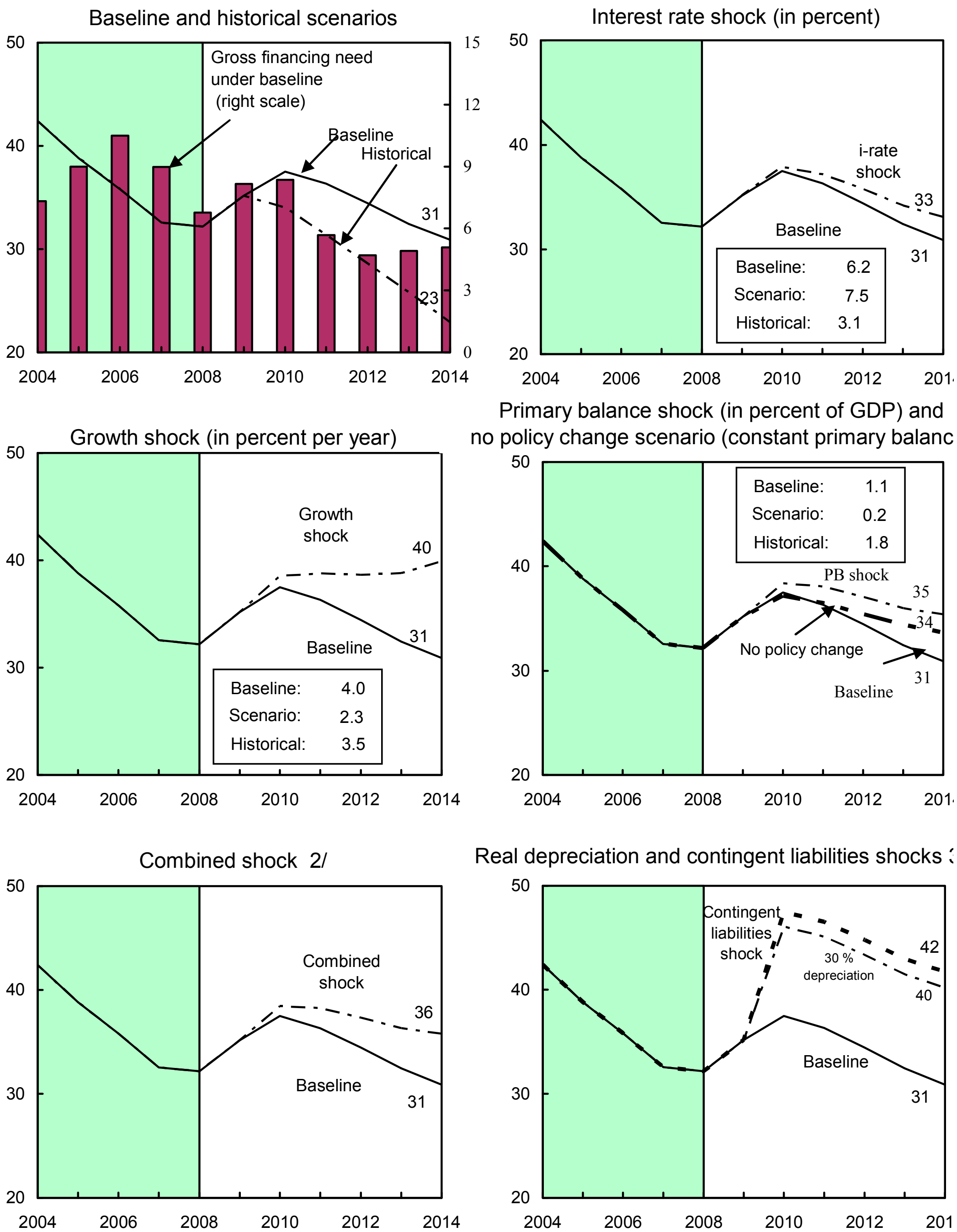
[1] Colombia has not had outstanding obligations to the Fund since the 1970s, despite three consecutive arrangements in the last decade.

Figure 6. Colombia: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2009.

Figure 7. Colombia: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in tl boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domes inflation (based on GDP deflator).

23. **In line with the Fund's safeguards assessment policy under the FCL, the authorities have indicated that they will provide staff with the necessary information.** Banco de la República publishes its balance sheet on a monthly basis on its website, as well as the auditor's notes and the external auditor's report, and would provide Fund staff with all additional information as well as discuss with them the audit findings together with its external auditors.[2]

VI. Staff Appraisal

24. **An FCL arrangement would help bolster confidence in Colombia at a time of heightened global uncertainty**. Despite Colombia's very strong underlying fundamentals, the deterioration of the global situation represents a source of risks to the near-term outlook. Access under the FCL arrangement of 900 percent of quota would provide an important backstop against a further deterioration of global conditions and reassure markets that Colombia will have room to maneuver in the period ahead, thereby reducing the likelihood of a negative shock to investor sentiment. From a domestic policy perspective, this additional insurance to the balance of payments would allow the authorities to maintain some scope for countercyclical policies.

25. **The authorities' policy response to the global crisis has been prudent and appropriate.** With inflation abating, monetary policy has been eased to support domestic demand. The authorities are also allowing automatic fiscal stabilizers to operate fully, while preserving medium-term fiscal sustainability. The exchange rate has been an effective shock absorber with limited rules-based intervention to smooth volatility, and reserve losses have been small. The authorities have taken timely steps to protect the financial system by increasing the deposit insurance coverage, and also to avert a possible liquidity crunch by securing external financing to the state-owned foreign trade bank to provide loans to banks and corporations facing reduced access to external credit.

26. **The staff assess that Colombia fully meets the qualification criteria set out for access to FCL resources and recommends approval of an FCL arrangement of SDR6.966 billion for a period of 12 months.** The very strong fundamentals and institutional framework, as well as the proven track record gives confidence that the authorities will maintain sound policies in the future, reacting appropriately to any balance of payments difficulties that may arise. Risks to the Fund are contained by the very strong rules-based policy setting, Colombia's very strong record of debt servicing, as well as the manageable external debt service profile. Moreover, Colombia fully meets the qualification criteria for use of GRA resources under the FCL, which dovetails with the very positive assessment of policies by the Executive Board in the context of the 2008 Article IV consultation.

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[2] http://www.banrep.gov.co/el-banco/ef_1.htm

Table 1. Colombia: Selected Economic and Financial Indicators

I. Social and Demographic Indicators

Population (millions), 2008	48.3	Physicians (per 100,000 people), 2000-2004	135.0
GDP, 2008		Adult illiteracy rate (percent ages 15 and older),	7.2
per capita (US$)	4,982	Sustainable access to safe water, 2004	
in billions of Col$	479,264	(percent of population)	93.0
in billions of US$	240.7	Gini index, 2003	58.6
Unemployment rate, February 2009 (percent)	12.5	Inequality (ratio of richest 20% to poorest 20%),	25.3
Life expectancy at birth (years) (HDI), 2005	72.3	Poverty rate, 2006	45.1
Under 5 mortality rate (per 1,000 live births), 2	21.0	Extreme poverty rate, 2006	12.0

II. Economic Indicators

					Staff projections	
	2005	2006	2007	2008	2009	2010
	(Percentage changes, unless otherwise indicated)					
National income and prices						
Real GDP	5.7	6.9	7.5	2.5	0.0	1.3
GDP deflator	6.1	6.8	4.8	8.2	2.4	4.8
Consumer prices (average)	5.0	4.3	5.5	7.0	5.4	4.0
Consumer prices (end of period)	4.9	4.5	5.7	7.7	4.6	3.6
External sector (on the basis of US$)						
Exports (f.o.b.)	26.2	15.9	21.4	26.1	-28.7	8.1
Imports (f.o.b.)	26.8	23.5	25.4	20.5	-21.0	4.9
Terms of trade (deterioration -)	12.6	2.8	3.5	11.5	-22.0	8.3
Real effective exchange rate (depreciation -)	11.6	-1.9	8.2	-4.4	...	...
Central government						
Revenue	14.8	22.8	14.8	16.0	4.1	3.5
Expenditure	10.3	16.8	9.9	12.9	14.7	4.6
Money and credit						
Broad money	17.6	18.0	17.4	18.5	12.3	10.5
Credit to the private sector	11.3	38.5	23.5	17.5	...	...
Interest rate (90-day time deposits; percent per year) 1/						
Nominal	6.3	6.8	9.2	9.8	8.3	…
Real	1.4	2.3	3.5	2.1	1.9	…
	(In percent of GDP)					
Central government balance	-4.1	-3.4	-2.7	-2.3	-4.2	-4.3
Nonfinancial public sector balance	0.0	-1.0	-0.8	-0.3	-2.8	-3.4
NFPS primary balance	3.4	2.9	3.2	3.6	0.6	0.2
Combined public sector balance	0.0	-0.7	-0.7	-0.1	-2.9	-3.1
Foreign financing	-1.4	0.3	0.3	0.4	1.6	0.6
Domestic financing 2/	1.4	0.4	0.4	-0.4	0.4	2.5
Privatization	0.0	0.0	0.0	0.1	0.9	0.0
Public debt	38.8	35.8	32.6	32.2	35.7	37.0
Gross domestic investment	21.6	24.3	24.3	24.7	22.0	22.1
Gross national savings	20.3	22.5	21.5	21.9	18.1	18.8
Current account (deficit -)	-1.3	-1.8	-2.8	-2.8	-3.9	-3.3
External debt	26.6	24.7	21.4	19.3	24.3	23.5
Of which: public sector	16.7	16.2	13.9	12.2	17.1	17.4
NIR in percent of short-term debt	108.1	147.0	198.1	190.7	183.8	207.0
	(In percent of exports of goods, services, and income)					
External debt service	45.8	35.4	25.1	21.9	31.0	31.1
Of which: public sector	31.0	20.0	14.4	12.3	12.6	13.2
Interest payments	11.8	9.4	9.0	8.5	10.5	9.3
Of which: public sector	8.7	6.4	6.2	6.0	7.0	6.6
	(In millions of U.S. dollars)					
Overall balance of payments	1,729	23	4,714	2,638	-247	748
Exports (f.o.b.)	21,729	25,181	30,577	38,546	27,495	29,730
Of which: Petroleum products	5,559	6,328	7,318	12,204	6,529	8,000
Coffee	1,471	1,461	1,714	1,883	1,611	1,676
Gross official reserves	14,634	15,109	20,607	23,672	23,425	24,173
Gross official reserves (in months of imports of goods and services)	5.8	4.8	5.5	7.8	7.4	7.2

Sources: Colombian authorities; UNDP Human Development Report 2007/08; World Development Indicators; and Fund staff estimates and projections.

1/ Data for 2009 refer to March.

2/ Includes the quasi-fiscal balance of Banco de la República, sales of assets, phone licenses, and statistical discrepancy.

Table 2. Colombia: Summary Balance of Payments

					Staff Projections	
	2005	2006	2007	2008	2009	2010
	(In millions of U.S. dollars)					
Current account balance	**-1,882**	**-2,983**	**-5,837**	**-6,765**	**-7,709**	**-6,709**
Trade balance	1,595	322	-596	990	-2,161	-1,392
Exports, f.o.b.	21,729	25,181	30,577	38,546	27,495	29,730
Coffee	1,471	1,461	1,714	1,883	1,611	1,676
Petroleum products	5,559	6,328	7,318	12,204	6,529	8,000
Non-traditional	9,863	11,749	15,174	17,101	14,418	14,197
Other	4,836	5,642	6,370	7,358	4,936	5,856
Imports, f.o.b.	20,134	24,859	31,173	37,556	29,656	31,122
Services (net)	-2,102	-2,119	-2,607	-3,129	-2,730	-2,785
Income (net)	-5,456	-5,929	-7,865	-10,121	-7,354	-7,269
Interest (net)	-2,051	-1,693	-1,750	-2,016	-2,639	-2,052
Of which : public sector	-1,587	-1,208	-1,279	-1,445	-1,769	-1,565
Other Income (net)	-3,405	-4,236	-6,115	-8,105	-4,714	-5,217
Current transfers (net)	4,082	4,743	5,231	5,495	4,535	4,736
Financial account balance	**3,236**	**2,890**	**10,344**	**9,546**	**7,462**	**7,457**
Public sector (net)	-2,974	-432	2,198	-309	4,797	1,897
Nonfinancial public sector	-2,129	722	1,928	-95	4,687	1,470
Medium- and long-term (net)	-1,189	2,085	1,298	998	4,398	1,253
Disbursements	4,312	5,869	4,096	3,246	5,964	3,327
Amortization	5,501	3,784	2,798	2,248	1,566	2,073
Other long-term flows	-47	-46	-19	-1	-2	-2
Short term 1/	-893	-1,317	649	-1,092	291	218
Of which : change in public assets	-849	-1,598	-662	-50	291	218
Financial public sector	-845	-1,154	270	-215	110	427
Private sector (net)	6,210	3,322	8,146	9,856	2,666	5,560
Nonfinancial private sector (net)	6,122	3,380	7,915	8,964	2,801	5,786
Direct investment	5,590	5,558	8,136	8,406	6,276	6,556
Direct investment abroad	4,662	1,098	913	2,158	1,564	1,004
Direct investment in Colombia	10,252	6,656	9,049	10,564	7,840	7,560
Leasing finance	116	62	116	277	-373	-288
Disbursements	378	501	656	1,004	550	573
Amortization	262	439	540	726	923	861
Long-term loans	-436	-79	951	374	-1,344	-1,592
Disbursements	1,948	2,837	3,031	2,061	2,016	2,388
Amortization	2,385	2,916	2,080	1,688	3,360	3,980
Short term 2/	853	-2,161	-1,289	-93	-1,759	1,110
Financial private sector (net)	88	-57	231	892	-135	-226
Net errors and omissions	**374**	**115**	**204**	**-149**	**0**	**0**
Changes in GIR 3/	**1,729**	**23**	**4,714**	**2,638**	**-247**	**748**
Memorandum Items:						
Current account balance (in percent of GDP)	-1.3	-1.8	-2.8	-2.8	-3.9	-3.3
Oil Price (Colombian mix)	49.8	58.3	66.2	90.2	48.3	58.1
Gross international reserves (in US$ billion)	14.6	15.1	20.6	23.7	23.4	24.2
Gross international reserves (months of imports of G&S)	5.8	4.8	5.5	7.8	7.4	7.2

Sources: Banco de la República; and Fund staff estimates and projections.
1/ Includes movements of short-term assets owned by the public sector abroad.
2/ Includes net portfolio investment.
3/ Does not include valuation changes of reserves denominated in other currencies than U.S. dollars.

Table 3. Colombia: External Financing Requirements and Sources
(In millions of U.S. dollars)

			Staff Projections			
	2007	2008	2009		2010	
			Baseline	Adverse Scenario	Baseline	Adverse Scenario
Gross financing requirements	21,228	19,479	19,828	21,903	20,001	21,718
External current account deficit	5,837	6,765	7,709	9,784	6,709	9,173
Debt amortization	10,678	10,076	12,365	12,365	12,544	12,544
Medium and long term debt	5,662	5,059	6,396	6,396	7,356	7,356
Public sector	2,898	2,380	1,736	1,736	2,214	2,214
Private sector	2,764	2,679	4,660	4,660	5,142	5,142
Short-term debt 1/	5,015	5,018	5,970	5,970	5,188	5,188
Public sector	695	552	695	695	695	695
Private sector	4,321	4,466	5,275	5,275	4,493	4,493
Gross reserves accumulation	4,714	2,638	-247	-247	748	0
Available financing	21,228	19,479	19,828	16,087	20,001	13,502
Foreign direct investment (net)	8,136	8,406	6,276	5,335	6,556	5,901
o/w inward (net)	9,049	10,564	7,840	6,664	7,560	6,426
Medium and long-term debt disbursements	8,355	5,615	8,448	8,448	6,464	5,683
Public sector	4,487	3,425	6,243	6,243	3,895	3,114
Private sector	3,868	2,190	2,205	2,205	2,569	2,569
Non financial	3,031	2,061	2,016	2,016	2,388	2,388
Financial	837	128	188	188	181	181
Public sector use of external assets	-662	-50	291	291	218	218
Short-term debt 2/	5,161	5,827	5,188	2,388	5,358	2,075
Public sector	695	552	695	278	695	278
Private sector	4,466	5,275	4,493	2,110	4,663	1,797
Other capital flows (net) 3/	238	-319	-375	-375	1,405	-375
Financing gap analysis (in US$ millions, unless specified)						
Current account shock				2,075		1,716
In percent of quota				179		148
Capital account shock				3,741		6,499
In percent of quota				323		561
Combined shock				5,816		8,215
In percent of quota				502		709
Memorandum items:						
100 percent of quota (in SDR million)				774		774
100 percent of quota (in US$ million)				1,159		1,159

Sources: Banco de la República and Fund staff estimates.

1/ Original maturity of less than 1 year. Stock at the end of the previous period.
2/ Original maturity of less than 1 year. Stock at the end of the current period.
3/ Includes all other net financial flows, and errors and omissions.

Table 4. Colombia: Structure of External Debt

	2004	2005	2006	2007	2008
	(In millions of US$)				
I. Gross external debt	**39,497**	**38,507**	**40,103**	**44,553**	**46,392**
A. Public sector external	25,835	24,189	26,299	28,819	29,447
Long- and medium-term	25,444	23,790	26,045	28,124	28,895
Short-term	391	399	254	695	552
B. Private sector external debt	13,662	14,317	13,803	15,734	16,945
B.1. Non Financial	12,154	12,034	11,918	12,716	13,899
Long- and medium-term	9,179	8,845	9,096	10,206	10,869
Short-term	2,975	3,188	2,822	2,510	3,030
B.2. Financial	1,508	2,283	1,885	3,018	3,045
Long- and medium-term	152	516	386	1,079	943
Short-term	1,356	1,767	1,499	1,939	2,102
	(In percent of GDP)				
I. Gross external debt	**34.7**	**26.6**	**24.7**	**21.4**	**19.3**
A. Public sector external	22.7	16.7	16.2	13.9	12.2
Long- and medium-term	22.4	16.5	16.0	13.5	12.0
Short-term	0.3	0.3	0.2	0.3	0.2
B. Private sector external debt	12.0	9.9	8.5	7.6	7.0
B.1. Non Financial	10.7	8.3	7.3	6.1	5.8
Long- and medium-term	8.1	6.1	5.6	4.9	4.5
Short-term	2.6	2.2	1.7	1.2	1.3
B.2. Financial	1.3	1.6	1.2	1.5	1.3
Long- and medium-term	0.1	0.4	0.2	0.5	0.4
Short-term	1.2	1.2	0.9	0.9	0.9

Source: Banco de la Republica, and Fund staff estimates.

Table 5. Colombia: Operations of the Combined Public Sector 1/
(In percent of GDP)

	2005	2006	2007	2008	Staff Projections 2009	2010
Total revenue	26.1	27.3	27.1	26.3	26.3	25.1
Tax revenue	14.9	19.3	19.3	19.2	19.0	19.0
Nontax revenue	11.1	8.1	7.8	7.1	7.2	6.1
Financial income	1.3	1.2	1.4	1.3	1.0	0.9
Operating surplus of public enterprises	3.3	3.6	3.2	0.4	0.1	0.1
Of which : Ecopetrol	3.1	3.4	3.0	0.0	0.0	0.0
Other	6.6	3.3	3.2	5.4	6.1	5.1
Total expenditure and net lending 2/	26.2	28.2	28.2	26.6	29.1	28.5
Current expenditure	21.2	22.6	21.8	21.6	23.1	22.7
Wages and salaries	5.7	5.8	5.6	5.6	5.8	5.7
Goods and services	3.6	3.6	3.6	3.5	3.3	3.2
Interest	3.4	3.9	4.0	3.8	3.4	3.6
External	1.4	1.2	1.0	1.0	1.0	1.1
Domestic	2.0	2.7	3.1	2.8	2.4	2.5
Transfers to private sector	6.7	7.3	7.2	7.4	9.3	8.1
Of which: from social security	5.8	6.4	6.4	6.6	7.4	7.4
Other 3/	1.8	2.0	1.3	1.3	1.3	2.1
Capital expenditure	5.0	5.5	6.4	5.0	5.9	5.9
Fixed capital formation (cash basis)	4.9	5.4	6.3	4.9	5.9	5.8
Transfers	0.0	0.0	0.0	0.0	0.0	0.0
Other (including floating debt) 3/	0.0	0.0	0.1	0.0	0.0	0.0
Net lending	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy	0.1	-0.2	0.2	0.0	0.0	0.0
Nonfinancial public sector balance	0.0	-1.0	-0.8	-0.3	-2.8	-3.4
Quasi-fiscal balance (BR cash profits)	0.2	0.4	0.4	0.3	0.0	0.3
Fogafin balance	0.2	0.2	0.1	0.1	0.1	0.1
Net cost of financial restructuring 4/	-0.4	-0.3	-0.3	-0.3	-0.2	-0.1
Combined public sector balance	0.0	-0.7	-0.7	-0.1	-2.9	-3.1
Memorandum items:						
NFPS primary balance	3.4	2.9	3.2	3.5	0.6	0.2
NFPS primary structural balance 5/	3.2	2.9	2.2	2.1	1.9	1.7

Sources: Ministry of Finance; Banco de la República; and Fund staff estimates and projections.

1/ Combined public sector includes the central, regional and local governments, social security, and public sector enterprises. Figures for 2008 and projections reflect exclusion of Ecopetrol operations and privatization of health care, which reduces revenue and spending by about 2 percent of GDP and 1.5 percent of GDP, respectively, in 2008.

2/ Expenditure reported on commitments basis.
3/ Includes adjustments to put spending on commitment basis and the change in unpaid bills of selected nonfinancial public enterprises.
4/ Interest payments on public banks restructuring bonds and mortgage debt relief related costs.
5/ Removes cyclical component by adjusting for the output gap and commodity price expectations.

Table 6. Colombia: Financial Soundness Indicators
Total Banking System
(In percent, unless otherwise indicated; end-of-period values)

	2004	2005	2006	2007	Feb-08	2008	Feb-09
Capital Adequacy							
Regulatory capital to risk-weighted assets	14.2	14.7	13.1	13.6	14.5	13.4	15.0
Regulatory Tier 1 capital to risk-weighted assets	10.7	10.4	9.7	10.5	11.5	10.7	12.2
Capital (net worth) to assets	12.1	12.3	12.0	12.1	12.2	12.2	12.5
Asset Quality and Distribution							
Nonperforming loans to gross loans	3.3	2.7	2.6	3.3	3.6	4.0	4.5
Provisions to nonperforming loans	149.7	166.9	153.6	132.6	121.0	120.5	112.9
Government securities to assets	23.8	24.9	15.5	12.2	12.3	13.5	14.6
Gross loans to assets	52.0	52.3	60.6	64.3	64.7	64.6	62.6
Earnings and Profitability							
ROAA	2.7	2.7	2.5	2.4	2.1	2.4	2.5
ROAE	23.0	22.1	20.2	19.5	17.2	20.0	20.1
Interest margin to gross income	38.9	40.2	46.6	54.4	58.6	54.3	52.5
Interest income to gross income	39.3	42.8	39.6	44.9	46.3	48.5	49.8
Operating expenses to gross income	60.7	57.2	60.4	55.1	53.7	51.5	50.2
Liquidity							
Liquid assets to total assets	20.6	20.8	14.0	13.0	12.8	13.9	16.4
Liquid assets to short-term liabilities	31.2	31.3	20.7	19.3	19.0	20.5	24.3
Loan to deposit ratio 1/	78.8	79.0	89.7	95.8	95.9	95.3	92.9

Sources: Superintendencia Financiera; and Creditedge (Moody's-KMV).

1/ The denominator includes certificates of deposits.

Table 7. Colombia: External Debt Sustainability Framework, 2004-2014
(In percent of GDP, unless otherwise indicated)

	Actual					Staff Projections 1/						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Debt-stabilizing non-interest current account 7/
Baseline: External debt	34.7	26.6	24.7	21.4	19.3	**24.3**	**23.5**	**21.9**	**20.2**	**18.8**	**16.9**	**-2.9**
Change in external debt	-6.8	-8.1	-2.0	-3.3	-2.1	5.0	-0.8	-1.6	-1.7	-1.4	-1.8	
Identified external debt-creating flows (4+8+9)	-9.8	-9.9	-4.5	-6.5	-3.6	0.7	-0.2	-1.1	-1.3	-1.6	-2.2	
Current account deficit, excluding interest payments	-1.4	-0.6	0.1	1.3	1.4	2.4	1.7	1.4	1.3	0.8	0.4	
Deficit in balance of goods and services	0.3	0.4	1.1	1.5	0.9	2.5	2.0	1.5	1.3	0.8	0.4	
Exports	17.1	16.9	17.6	16.4	17.7	15.9	16.6	17.0	17.1	17.4	17.8	
Imports	17.4	17.2	18.7	18.0	18.6	18.4	18.6	18.5	18.4	18.2	18.2	
Net non-debt creating capital inflows (negative)	-2.6	-3.9	-3.4	-3.9	-3.5	-3.2	-3.2	-3.0	-2.8	-2.7	-3.0	
Automatic debt dynamics 2/	-5.8	-5.5	-1.2	-3.9	-1.5	1.5	1.3	0.5	0.2	0.2	0.4	
Contribution from nominal interest rate	2.2	1.9	1.7	1.5	1.4	1.5	1.6	1.4	1.2	1.2	1.2	
Contribution from real GDP growth	-1.6	-1.6	-1.6	-1.5	-0.5	0.0	-0.3	-0.9	-1.0	-0.9	-0.8	
Contribution from price and exchange rate changes 3/	-6.5	-5.8	-1.3	-3.9	-2.4	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 4/	3.0	1.9	2.6	3.2	1.5	4.3	-0.6	-0.5	-0.4	0.2	0.4	
External debt-to-exports ratio (in percent)	202.8	157.9	140.4	130.2	109.1	152.6	141.6	128.9	118.0	107.6	95.1	
Gross external financing need (in billions of US dollars) 5/	9.6	15.0	16.2	16.1	17.0	20.1	19.3	17.6	18.4	16.9	19.1	
in percent of GDP	8.4	10.3	10.0	7.7	7.1	10.1	9.4	8.1	7.8	6.7	7.1	
Scenario with key variables at their historical averages 6/						**24.3**	**21.4**	**18.6**	**15.7**	**13.3**	**10.9**	**-2.2**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.7	5.7	6.9	7.5	2.5	0.0	1.3	4.0	5.0	5.0	4.5	
GDP deflator in US dollars (change in percent)	18.5	20.2	5.1	19.0	12.8	-17.5	2.0	2.5	2.6	1.8	1.9	
Nominal external interest rate (in percent)	6.7	7.0	7.2	7.6	7.5	6.4	6.6	6.3	6.0	6.3	6.6	
Growth of exports (US dollar terms, in percent)	23.8	25.2	17.1	19.8	24.5	-25.8	7.4	9.3	8.4	9.1	8.7	
Growth of imports (US dollar terms, in percent)	19.2	25.7	21.9	23.3	19.5	-18.4	4.5	6.2	6.9	5.9	6.2	
Current account balance, excluding interest payments	1.4	0.6	-0.1	-1.3	-1.4	-2.4	-1.7	-1.4	-1.3	-0.8	-0.4	
Net non-debt creating capital inflows	2.6	3.9	3.4	3.9	3.5	3.2	3.2	3.0	2.8	2.7	3.0	

1/ Does not assume any drawings under the Flexible Credit Line arrangement.

2/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

3/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

4/ For projection, line includes the impact of price and exchange rate changes.

5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

6/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 8. Colombia: Public Sector Debt Sustainability Framework, 2004-2014
(In percent of GDP, unless otherwise indicated)

	Actual					Staff Projections 1/						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Debt-stabilizing primary balance 11/
Baseline: Public sector debt 2/	42.4	38.8	35.8	32.6	32.2	**35.7**	**37.0**	**35.9**	**34.0**	**32.0**	**30.5**	**0.9**
o/w foreign-currency denominated	22.7	16.7	16.2	13.9	12.2	17.1	17.4	16.4	15.1	14.2	12.7	
Change in public sector debt	-3.8	-3.6	-3.0	-3.2	-0.4	3.5	1.3	-1.1	-1.8	-2.0	-1.5	
Identified debt-creating flows (4+7+12)	-7.9	-5.4	-4.3	-4.5	-1.5	1.2	1.4	-0.4	-1.1	-1.2	-0.7	
Primary deficit	-3.0	-3.2	-3.0	-3.0	-3.6	-0.6	-0.2	-1.1	-1.4	-1.5	-1.4	
Revenue and grants	25.9	26.1	27.3	27.1	26.5	26.3	25.1	24.7	24.4	24.3	24.3	
Primary (noninterest) expenditure	22.9	22.8	24.3	24.1	22.9	25.7	24.9	23.7	23.0	22.8	22.9	
Automatic debt dynamics 3/	-4.9	-2.2	-1.3	-1.5	2.2	2.7	1.5	0.6	0.3	0.3	0.7	
Contribution from interest rate/growth differential 4/	-1.4	-1.2	-1.0	0.0	0.6	2.7	1.5	0.6	0.3	0.3	0.7	
Of which contribution from real interest rate	0.5	0.9	1.4	2.4	1.3	2.7	2.0	2.0	2.0	1.9	2.1	
Of which contribution from real GDP growth	-1.9	-2.2	-2.4	-2.4	-0.7	0.0	-0.4	-1.4	-1.6	-1.6	-1.3	
Contribution from exchange rate depreciation 5/	-3.5	-1.0	-0.3	-1.5	1.6	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	-0.1	-0.9	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	-0.1	-0.9	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 6/	4.1	1.8	1.3	1.3	1.1	2.3	0.0	-0.7	-0.7	-0.8	-0.9	
Public sector debt-to-revenue ratio 2/	163.8	149.0	131.0	120.0	121.5	135.9	147.5	145.0	139.2	131.8	125.5	
Gross financing need 7/	7.3	9.0	10.5	9.0	6.8	8.1	8.3	5.7	4.7	4.9	5.1	
in billions of U.S. dollars	8.3	13.0	17.1	18.7	16.3	16.2	17.1	12.4	11.0	12.3	13.5	
Scenario with key variables at their historical averages 8/						**35.7**	**33.6**	**30.9**	**28.1**	**25.3**	**22.5**	**0.0**
Scenario with no policy change (constant primary balance) in 2009-2014						**35.7**	**36.6**	**36.0**	**35.0**	**33.9**	**33.3**	**0.9**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.7	5.7	6.9	7.5	2.5	0.0	1.3	4.0	5.0	5.0	4.5	
Average nominal interest rate on public debt (in percent) 9/	10.0	8.9	11.4	12.7	13.0	10.9	10.7	9.6	10.1	9.9	10.5	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.7	2.8	4.6	8.0	4.8	8.5	5.9	6.0	6.2	6.2	7.1	
Nominal appreciation (increase in US dollar value of local currency, in percent)	16.3	4.6	2.0	11.1	-10.4	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	8.3	6.1	6.8	4.8	8.2	2.4	4.8	3.6	3.9	3.7	3.4	
Growth of real primary spending (deflated by GDP deflator, in percent) 10/	-0.4	5.6	13.7	6.8	-2.6	12.0	-1.7	-1.3	2.2	3.9	5.3	
Primary deficit	-3.0	-3.2	-3.0	-3.0	-3.6	-0.6	-0.2	-1.1	-1.4	-1.5	-1.4	

1/ Does not assume any drawings under the Flexible Credit Line arrangement.
2/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
3/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
4/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.
5/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
6/ For projections, this line includes exchange rate changes.
7/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
8/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
9/ Derived as nominal interest expenditure divided by previous period debt stock.
10/ 2009 includes one-off payment of fuel subsidies.
11/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 9. Colombia: Indicators of Fund Credit, 2008-14

		Staff Projections					
	2008	2009	2010	2011	2012	2013	2014
Stocks from prospective drawings 1/							
Fund credit in millions SDR		6,966	6,966	6,966	5,225	1,742	0
In percent of quota		900	900	900	675	225	0
In percent of GDP		5.3	5.1	4.8	3.3	1.0	0.0
In percent of exports of goods and services		33.0	30.7	28.1	19.5	5.9	0.0
In percent of gross reserves 2/		29.3	43.9	43.9	32.9	11.0	0.0
Flows from prospective drawings 3/							
Amortization		0	0	0	1,742	3,483	1,742
GRA Charges		49.2	103.1	103.1	100.3	59.3	10.7
Level Based Surcharge		48.0	100.6	100.6	96.8	41.5	0.9
Service Charge		34.8	0.0	0.0	0.0	0.0	0.0
Debt service due on GRA credit (millions SDR)		132	204	204	1,939	3,584	1,753
In percent of quota		17.0	26.3	26.3	250.5	463.0	226.5
In percent of GDP		0.1	0.1	0.1	1.2	2.1	1.0
In percent of exports of goods and services		0.6	0.9	0.8	7.2	12.2	5.5
In percent of gross reserves 2/		0.8	1.3	1.3	12.2	22.6	11.0
Memo Item:							
Total External Debt, assuming full drawing (% of GDP)	19.3	29.6	28.6	26.7	23.5	19.8	16.9
Total Debt Service, assuming full drawing (% of GDP)	3.4	5.0	5.3	4.3	5.5	5.8	5.5

Sources: IMF Finance Department; Colombian authorities, and Fund staff estimates

1/ End of period. Assumes full drawings under the FCL upon approval. The Colombian authorities have expressed their intention to treat the arrangement as precautionary. At an SDR/US$ rate of 0.667578 as of May 1, 2009.

2/ Excludes IMF purchases.

3/ Based on the rate of charge as of April 23, 2009. Includes surcharges under the system currently in force and service charges.

Bogotá, April 30, 2009

Dear Mr. Strauss-Kahn,

We welcome the Flexible Credit Line (FCL) recently created by the International Monetary Fund. We view this facility as a major step forward in adapting the Fund to better serve the needs of its membership in a vastly changed global landscape. In particular, we think the FCL will provide much needed insurance against large external shocks for countries, like Colombia, that are highly integrated to the global economy, and have solid institutions and sustained track records of very strong economic policies.

On this basis, responding to your invitation, we would like to request the Fund to approve an FCL arrangement for Colombia in the amount of SDR 6.966 billion (900 percent of quota), covering a period of 12 months. As we are confident that Colombia is well prepared to weather the current adverse external environment, we intend to treat the arrangement as precautionary. Our expectation is that the arrangement will bolster confidence that Colombia is in a position to withstand a wider range of adverse external shocks.

Thanks to our strong macroeconomic policies and solid institutional framework, Colombia has attained a comfortable external position and greatly reduced its external vulnerabilities. The flexible exchange rate regime has served as an effective shock absorber. Public debt is relatively low and our fiscal policies are solidly anchored on a medium term framework geared toward further debt reduction (see recent document on our medium-term fiscal framework). [1] Our monetary policy framework, based on an inflation targeting regime, has helped anchor inflation expectations in the single digits and facilitated a quick disinflation following the supply shocks of 2008 (see latest inflation report).[2] Reserve coverage in terms of imports and short-term debt is comfortable. As in the case of the public debt, the external debt-to-GDP ratio is relatively low and on a firmly declining path.

The improvement in economic fundamentals has provided space for fiscal and monetary policies to be increasingly geared to support domestic demand during the current global crisis. Our prudent fiscal policy will allow automatic fiscal stabilizers to operate in the near term, providing economic stimulus. We have also allowed for some monetary easing since last year by lowering reserve requirements and the policy rate (300 bps), and may allow for some further easing if downside risks to the economy materialize and inflation expectations remain anchored.

[1] http://www.minhacienda.gov.co/portal/page/portal/63C6063432B576F2E040090A1F003C0D

[2] http://www.banrep.gov.co/documentos/publicaciones/inflacion/2008/informe_dic_08.pdf

Our strong policies and institutional framework have facilitated continued access to international capital markets at favorable terms for the government and private sector. In addition, a strong supervisory and regulatory framework have helped mitigate the effects of the global deleveraging underway on our financial system. Banks' balance sheets are strong and free of large exposures to risky products. Capital to risk-weighted assets for the system as a whole is well above requirements and, despite a slowdown in private sector credit growth, banks remain profitable and provisioning levels comfortable (see latest Financial Stability Report).[3]

Overall, we believe that Colombia's track record on the macroeconomic front added to its solid institutional framework provides ample assurances of the country's preparedness to withstand adverse shocks, and of our commitment to maintaining sound policies in the future and to continue to react as needed if further shocks were to materialize in the period covered by the FCL arrangement. In this regard, we take this opportunity to inform you that Banco de la Republica will provide to the Fund staff all needed information and send the requested authorizations to the bank's external auditors, in accordance with the safeguards policy for the FCL. In sum, we fully concur with the views expressed by Executive Directors during the last Article IV consultation, namely, that Colombia is well placed to confront the challenges posed by the ongoing global downturn.

Sincerely yours,

/ s /

Jose Dario Uribe
Governor
Central Bank of Colombia

/ s /

Oscar Ivan Zuluaga
Minister of Finance and Public Credit

[3] http://www.banrep.gov.co/documentos/publicaciones/report_estab_finan/2009/marzo.pdf

INTERNATIONAL MONETARY FUND

Colombia—Assessment of the Impact of the Proposed Flexible Credit Line Arrangement on the Fund's Finances and Liquidity Position

Prepared by the Finance and Strategy, Policy and Review Departments

(In consultation with other Departments)

Approved by Andrew Tweedie and Tessa van der Willigen

May 5, 2009

1. **This note assesses the impact of the proposed Flexible Credit Line (FCL) arrangement for Colombia on the Fund's finances and liquidity position, in accordance with the policy on the FCL.**[1] The proposed arrangement would cover a 12-month period, and be in an amount of SDR 6.966 billion (900 percent of quota). The full amount of access proposed would be available throughout the arrangement period, in one or multiple purchases.[2] The authorities intend to treat the arrangement as precautionary.

I. Background

2. **Colombia had three Fund arrangements during the past decade but has not drawn on Fund resources since 1971** (Table 1). Colombia had a series of Stand-By Arrangements (SBAs) in close succession from the late 1950s to mid-1970s. It last made purchases in 1971 and extinguished its remaining outstanding obligations to the Fund in 1972. Following a quarter century without Fund arrangements, Colombia's economic performance deteriorated markedly in 1998–99 as a result of external shocks and intensified domestic tensions. To address the economic difficulties, a three-year Extended Arrangement (EA) under the Extended Fund Facility (EFF) was approved to support the authorities' economic reform program in 1999. No drawings were made under this EA which was followed by two precautionary SBAs, the last of which expired in November 2006. With the support of these three successive Fund arrangements, Colombia successfully adopted wide ranging macroeconomic and structural reforms.

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[1] See *GRA Lending Toolkit and Conditionality—Reform Proposals* (3/13/09), and *GRA Lending Toolkit and Conditionality—Reform Proposals* (3/24/09).

[2] If the full amount is not drawn in the first six months of the arrangement, subsequent purchases are subject to a review of Colombia's continued qualification for the FCL arrangement.

Table 1. Colombia: IMF Financial Arrangements, 1999–2005
(In millions of SDR)

Year	Type of Arrangement	Date of Arrangement	Date of Expiration or Cancellation	Amount of New Arrangement	Amount Drawn	Purchases	Repurchases	Fund Exposure
1999	EFF	20-Dec-99	19-Dec-02	1,957.0	--	--	--	--
2000						--	--	--
2001						--	--	--
2002						--	--	--
2003	SBA	15-Jan-03	2-May-05	1,548.0	--	--	--	--
2004						--	--	--
2005	SBA	2-May-05	2-Nov-06	405.0	--	--	--	--

Source: Finance Department.

3. **Total external debt is relatively low and expected to remain sustainable even in the face of further significant negative shocks (Table 2).**[3] External debt has been declining relative to GDP in recent years, and was below 20 percent as of end-2008. The bulk of this debt is long-term and owed by the public sector. Private sector external debt has declined to about 7 percent of GDP. Over the medium term, the external current account deficit is expected to decline as a share of GDP, and be largely financed by FDI. Debt sustainability analysis suggests that external debt ratios would remain manageable even under significantly negative shocks.

Table 2. Colombia: Total External Debt, 2005–09

	2005	2006	2007	2008	2009 1/
	(In Millions of US Dollars)				
Total External Debt	38,507	40,103	44,553	46,392	48,227
Private	14,317	13,803	15,734	16,945	14,345
Public	24,189	26,299	28,819	29,447	33,882
	(In Percent of GDP)				
Total External Debt	26.6	24.7	21.4	19.3	24.3
Private	9.9	8.5	7.6	7.0	7.2
Public	16.7	16.2	13.9	12.2	17.1

Source: Colombian authorities and IMF staff estimates.

1/ Projected.

[3] A more detailed description and analysis of external and public debt is provided in the staff report.

II. IMPACT ON THE FUND'S FINANCES AND LIQUIDITY POSITION

4. **The substantial access under the proposed arrangement could add significantly to the Fund's credit exposure.** In terms of SDRs, the proposed FCL arrangement would be more than three and a half times Colombia's largest arrangement to date. If the full amount available under the FCL arrangement—which the authorities intend to treat as precautionary—were drawn, Colombia's outstanding use of GRA resources would reach SDR 6.966 billion, an individual country exposure which has previously been exceeded only for seven members.

5. **If the full amount available under the proposed FCL arrangement were purchased in 2009:**

- **Colombia's external debt position would increase somewhat, with Fund credit representing still a relatively modest part of this debt:** total external debt would rise to about 30 percent of GDP initially, and public external debt would rise to about 22 percent of GDP, with Fund credit at about 5 percent of GDP (Table 3). At its peak in 2009–11, Colombia's outstanding use of GRA resources would account for about 18 percent of total external debt, and slightly less than one-quarter of public external debt, and close to one-third of reserves.

- **External debt service would increase over the medium-term, but would remain manageable**. Colombia's projected debt service to the Fund would peak in 2013 at about SDR 3.6 billion, or about 2 percent of GDP.[4] In terms of exports of goods and services, debt service to the Fund would peak at about 12 percent, accounting for slightly over half of total public external debt service.

6. **Consistent with the level of access under the arrangement, the impact on the Fund's liquidity, and on its potential credit risk exposure, would be substantial:**

- **The proposed arrangement would reduce Fund liquidity by the full amount of available access** (Table 4). Approval of the proposed arrangement would reduce the one-year forward commitment capacity (FCC) by SDR 6.966 billion. In addition to quota resources included in the FCC, the Fund also has supplementary resources under the borrowing agreement with Japan.

[4] The figures on debt service used in this report are calculated assuming that full amount available under the arrangement is purchased upon approval of the arrangement, and that all repurchases are made as scheduled.

Table 3. Colombia: Capacity to Repay Indicators 1/

	2008	2009	2010	2011	2012	2013	2014
Exposure and Repayments (In SDR millions)							
GRA credit to Colombia	--	6,966.0	6,966.0	6,966.0	5,224.5	1,741.5	--
(In percent of quota)	--	(900.0)	(900.0)	(900.0)	(675.0)	(225.0)	--
Charges due on GRA credit 2/	--	131.9	203.7	203.7	197.0	100.8	11.6
Debt service due on GRA credit 2/	--	131.9	203.7	203.7	1,938.5	3,583.8	1,753.1
Debt and Debt Service Ratios 3/							
In percent of GDP							
Total external debt	19.3	29.6	28.6	26.7	23.5	19.8	16.9
Public external debt	12.2	22.3	22.4	21.2	18.4	15.2	12.7
GRA credit to Colombia	--	5.3	5.1	4.8	3.3	1.0	--
Total external debt service	3.4	5.0	5.3	4.3	5.5	5.8	5.5
Public external debt service	1.9	2.1	2.3	2.0	3.4	4.1	3.4
Debt service due on GRA credit	--	0.1	0.1	0.1	1.2	2.1	1.0
In percent of Gross International Reserves							
Total external debt	193.3	171.4	167.3	162.8	163.3	168.5	164.4
Public external debt	122.5	129.5	131.5	129.1	128.1	129.2	123.7
GRA credit to Colombia	--	30.5	29.8	29.2	23.1	8.8	--
In percent of Exports of Goods and Services							
Total external debt service	19.4	31.2	31.8	25.5	31.9	33.4	30.9
Public external debt service	10.9	13.0	14.0	11.9	19.6	23.3	18.8
Debt service due on GRA credit	--	0.6	0.9	0.8	7.2	12.2	5.5
In percent of Total External Debt							
GRA credit to Colombia	--	17.8	17.8	17.9	14.2	5.2	--
In percent of Public External Debt							
GRA credit to Colombia	--	23.5	22.7	22.6	18.0	6.8	--

Sources: Colombian authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ Assumes full drawings under the FCL upon approval. The Colombian authorities have expressed their intention to treat the arrangement as precautionary, as balance of payments pressures have not materialized.
2/ Based on the rate of charge as of April 23, 2009. Includes surcharges under the system currently in force and service charges.
3/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed FCL, adjusted for the impact of the assumed FCL drawing.

- **If the resources available under the FCL arrangement were fully drawn, GRA credit to Colombia as a share of total GRA credit would be about 25 percent.** As a result, the concentration of Fund credit among the top five users of Fund resources would increase to about 88 percent.

- **Potential GRA exposure to Colombia would be large in relation to the current level of the Fund's precautionary balances.** If the resources available under the arrangement were fully drawn, Fund credit to Colombia would be roughly equivalent to the Fund's current precautionary balances.

Table 4. FCL Arrangement for Colombia—Impact on GRA Finances
(In SDR millions, unless otherwise indicated)

	As of 4/24/2009
Liquidity measures	
Current one-year Forward Commitment Capacity (FCC) 1/	66,704
Japan borrowing agreement, available resources	66,809
Reduction in FCC on approval of FCL	6,966
Prudential measures, assuming full FCL drawing	
Fund credit to Colombia	
In percent of total GRA credit outstanding 2/	25.4
In percent of current precautionary balances	100.4
Fund credit outstanding to five largest debtors	
In percent of total GRA credit outstanding, before approval	86.3
In percent of total GRA credit outstanding, upon approval of the FCL 2/	87.7
Memorandum items	
Current precautionary balances (end-April 2008)	6,939
Total FCL commitments, including proposed FCLs	52,184
Quota of FTP members with actual and proposed FCLs, in percent of total quota of FTP members	3.0

Sources: Finance Department.

1/ The FCC measures the Fund's capacity to make new credit commitments over the next 12 months.
Does not include proposed commitments to Romania (SDR 11.4 billion) and Poland (SDR 13.7 billion).
2/ Based on current Fund credit outstanding plus full drawings under the proposed FCL.

III. Assessment

7. **The proposed arrangement would have a large but manageable impact on Fund liquidity.** Nonetheless, the Fund's liquidity has declined rapidly in recent weeks, and is likely to continue to decline as the Board considers forthcoming requests for arrangements. This underscores the need for continued close monitoring of liquidity, and to expedite the efforts to bring new borrowing agreements into effect to supplement the Fund's resources.

8. **Colombia intends to treat the FCL arrangement as precautionary, but if it did prove necessary to draw, the Fund's credit exposure to Colombia would be large.** The authorities' proven track record and their commitment to maintaining sound policies in the future provide very strong assurances that they would react appropriately to any balance of payments difficulties. Risks to the Fund are contained by the very strong rules-based policy setting, Colombia's very strong record of debt servicing, as well as the manageable external debt service profile, even in the event that the authorities were to draw the full amount available under the arrangement. Against this background, Colombia's capacity to repay is projected to remain strong. Nonetheless, the scale of the Fund's potential exposure to Colombia—in conjunction with the recent commitments to other members and the prospects for further credit expansion in the pipeline—underscores the need to strengthen the Fund's precautionary balances.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$10.5 Billion Arrangement for Colombia Under the Flexible Credit Line

The Executive Board of the International Monetary Fund (IMF) today approved a one-year SDR 6.966 billion (about US$10.5 billion) arrangement for Colombia under the Flexible Credit Line (FCL). The Colombian authorities have stated they intend to treat the arrangement as precautionary and not draw on the line.

The FCL is available to countries, such as Colombia, that have demonstrated a very strong track record of sound macroeconomic policies and institutional frameworks. The arrangement for Colombia is the second commitment in Latin America and the third overall (following arrangements for Mexico and Poland) under the IMF's FCL, which was created in the context of a major overhaul of the Fund's lending framework on March 24, 2009 (see Press Release No. 09/85 and Public Information Notice No. 09/40).

The FCL is designed to help countries' crisis prevention efforts by providing the flexibility to draw on the credit line at any time. Disbursements are not phased nor conditioned on compliance with policy targets as in traditional IMF-supported programs. This flexible access is justified on the basis that the strict qualification criteria for the FCL provides assurances that sound economic policies will remain in place to confront the challenges ahead.

Following the Executive Board discussion, Mr. John Lipsky, First Deputy Managing Director and Acting Chair, made the following statement:

"During the last decade, Colombia has maintained a very strong macroeconomic performance, underpinned by solid institutional policy frameworks. GDP growth has been robust. The inflation targeting regime brought inflation down to single digits. Anchored on its medium term fiscal framework, Colombia's debt ratios have declined substantially. The flexible exchange rate regime and prudent debt management have helped to reduce balance sheet vulnerabilities. Strong supervision and regulation have kept the financial system sound.

"Notwithstanding its very strong fundamentals, Colombia's near term outlook has been adversely affected by the global environment. While the flexible exchange rate absorbed the first round effects of the global crisis, weak external demand has led to a contraction of exports and a considerable slowdown in economic activity. Nonetheless, the financial system has not experienced major strains since the onset of the global crisis, and the Government of Colombia has maintained access to international capital markets at favorable terms.

"The authorities' policy response to the global crisis has been prudent and appropriate. With inflation abating, monetary policy has been eased. The authorities are also allowing automatic fiscal stabilizers to operate fully, while preserving medium-term fiscal sustainability. The exchange rate has been an effective shock absorber with limited rules-based intervention to smooth volatility, and reserve losses have been small. The authorities have taken timely steps to protect the financial system by increasing the deposit insurance coverage. They have also averted a possible liquidity crunch by securing external financing to the state-owned foreign trade bank which is providing loans to banks and corporations facing reduced access to external trade credit.

"The one-year arrangement under the IMF's Flexible Credit Line, which the authorities intend to treat as precautionary, will play an important role in bolstering confidence in the authorities' policy framework and strategy at a time of heightened global uncertainty. Colombia's strong fundamentals and institutional frameworks, its proven track record of sound macroeconomic policies, and the additional insurance provided by the FCL arrangement, give confidence that the authorities are well prepared to manage potential risks and pressures in the event that the global environment deteriorates further," Mr. Lipsky said.

Statement by María Inés Agudelo, Alternate Executive Director for Colombia
May 11, 2009

On behalf of my authorities, I want to thank staff and management for their positive response to the Colombian request for an FCL. The paper prepared by staff follows up on the recent discussion of the Article IV consultation, faithfully putting together the challenges that the Colombian authorities face in dealing with the global crisis.

The Request for an FCL

My authorities welcome the recently created FCL as the instrument that gives support to countries with strong fundamentals to weather the current international crisis. With a solid record of good policies and structural reforms, as was assessed during the last Article IV consultation, the Fund's support will boost confidence and will give assurances that Colombia is well prepared to face the current strains of the external environment, even if they further deteriorate.

There is no doubt that the external crisis has severely affected the Colombian economy. After several years of strong economic growth, it is now expected that the economy will slow down significantly, although it is not anticipated that it will fall into the negative territory. Consumer and business confidence has plummeted, while unemployment, lower remittances and lower terms of trade have affected disposable income and, consequently, weakened domestic demand. In addition, falling exports add to the domestic tensions.

During our recent discussion on Colombia, I have expressed my concerns on the risks of financing constraints that could limit the room for maneuver of policymakers. The good track record of economic policies has enabled the authorities for the first time to react to the external shocks with counter-cyclical policies. However, if those risks were to materialize, counter-cyclical policies would have to be restricted. With the announcement of Colombia's request for the FCL, spreads and interest rates on domestic treasuries lowered, boosting investors' confidence and giving support to the expected catalytic role of the Fund. This should help the authorities avoid pro-cyclical policies. External and local financing for both the public and private sectors should continue to flow at a lower cost, reducing the probability of the economy falling into even lower growth rates.

Convinced that the FCL will play this role, my authorities requested access for 900 percent of the quota, which they intend to treat as precautionary. Ten years ago, when Colombia requested the EFF, which was followed by two stand-by arrangements, the authorities did not draw on the Fund's resources while pursuing a strong reform agenda. The experience under those programs helped to gain the confidence of the external financial markets and the local financial sector. Under very different macroeconomic circumstances, today's Fund support with the FCL should lead to gains in confidence and reduce the effects of the external crisis in terms of economic growth.

Monetary and Exchange Rate Policies

The inflation-targeting framework has served the monetary authorities well. The consolidation of the framework has brought a reduction in inflation accompanied by a credible commitment to low inflation. In addition, it has given the authorities the flexibility and the opportunity to react to changing circumstances.

It should be remembered that between 2006 and 2007 domestic demand pressures threatened the accomplishment of inflation targets. Moreover, in 2007 and 2008 the effect of food and fuel price increases pushed inflation above targets. Facing this challenge, monetary policy was tightened and interest rates increased by 400 basis points. The significant response of the monetary policy meant that second round effects of food and fuel prices were contained and that when the external crisis hit the country, domestic demand was already responding to the monetary tightening. In addition, headline and core inflation have been falling since the fourth quarter of last year. In the same vein, now that external conditions are hitting domestic production particularly hard, the authorities have reacted quickly by reducing interest rates by 400 basis points since last December. Inflation expectations and projections have also experienced a marked correction and support a lower inflation rate, within the target, at the end of this year, and a continued downward trend towards its long-term objective.

The flexible approach to economic policy is also reflected in the exchange rate. The exchange rate policy has helped build international reserves during previous years and allowed an orderly peso-depreciation more recently, bringing stability under rapid changing external conditions. To reduce external vulnerabilities, the authorities have built a complete package of policy instruments that includes automatic interventions in the foreign exchange market in order to reduce volatility, direct interventions to build international reserves, restrictions on capital inflows, and regulations on financial institutions' open net foreign exchange positions, just to name a few. Today, the financial sector and the corporate sector have a low risk of exposure to exchange rate movements, while households are not exposed to foreign currencies at all. Under these circumstances, and with inflation expectations contained, the exchange rate has been allowed to float freely, with no significant intervention in the Forex market by the Central Bank throughout the year. Exchange rate flexibility has been a pillar of the countercyclical policy, since it has not obstructed the relaxation of monetary policy and has permitted the exchange rate to work as an absorber of the external shock.

Fiscal Policy

The medium-term fiscal framework is the instrument used by the authorities to show commitment to sustainable public finances. The fiscal framework sets the short-term fiscal target consistent with a reduced path of public debt. This framework has helped the authorities to have flexibility to accommodate shifting conditions and to foresee and react to future pressures on public expenditure or income tax cuts.

The global and national changing circumstances and their consequences on revenues have implied that the originally approved budget for fiscal years 2008 and 2009 would have meant deficits larger that the ones originally set in the fiscal framework. As a result, in mid-year 2008 and in January 2009, the fiscal authorities cut expenditures by around ½ percentage point of GDP each time, leading to close to fiscal equilibrium at the end of last year. For 2009, after the budget cut in January, the authorities decided to let automatic stabilizers operate and the fiscal deficit will be larger than originally expected.

On top of medium-term considerations, financing conditions have put a restriction to short term fiscal expansions. Nevertheless, to limit pro-cyclical policy reaction, the authorities have being active in assuring external and domestic financing. Even under the current stressed conditions, the Colombian government has taped external markets this year for US$ 2 billion with reasonable financial conditions and local financing has continued to operate smoothly (at the end of April the Treasury had already met more than half of the domestic financing target for the year). In addition, my authorities have being successful in finding support from other multilateral institutions.

Financial Sector

Institutional financial sector framework and policies have been strengthened significantly after the financial crisis at the end of the 90's. Since the FSAP update in 2005, Colombia has kept the banking system capitalized, improved financial legislation, and revamped the supervisory framework. The monetary, regulatory and supervisory authorities continue to keep a close vigilance of the financial system through the Committee of Financial Stability, which now meets once a month, and the Central Bank publishes a report on the stability of the financial system twice a year. This report assesses the stability of the system and evaluates its main risks in an open and transparent manner.

While the dynamics is not as strong as in previous years, credit growth and deposits are still growing at real positive rates. As the economy decelerates, NPLs have deteriorated somehow, but banks remain solvent and profitable. The replacement of private sector loans with government bonds in bank balance sheets has altered the nature of the risks confronting the banking sector, shifting from credit to liquidity risks. Given the strict regulation on foreign exchange exposures, the financial sector has a low exposure to the peso depreciation. Finally, financing to the corporate sector continued to flow in the local bond market with new bond issuances of more than US$ 1 billion during the first three months of this year.

Conclusions

I want to convey my authorities' commitment to keeping the track record of sound macroeconomic policies. The solid institutional framework has given support to respond to changing conditions and has helped the authorities to weather the global financial and economic crisis. They are committed to keep working under the same framework with the aim of keeping the country on a sustainable economic path. My authorities consent to the publication of the paper.